Real Estate Accounts

Treating of the Proper Classification, Construction, and Operation of Accounts for the Real Estate Business, including Forms

By

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PREFACE

It is a curious circumstance that, although accountants generally recognize the value of real estate as an asset, and frequently give evidence of that belief by assigning it a certain pre-eminence when marshalling assets or arranging a balance sheet, there is little literature on the subject of real estate accounting, either here or abroad.

One reason for this may be found in the fact that, until recently, we have been almost entirely dependent upon England and Scotland for our accountancy literature; and in those countries there is not the constant development of wild lands, timber tracts, and suburban properties, nor the large and rapid increase in the growth of cities, so evident throughout the United States; nor is there that habit of quick trading which here has become a second nature. Under such circumstances it is but natural that across the ocean the matter has been overlooked or postponed; and on this side of the water accountants have been so fully occupied in keeping abreast of their work that they have had but little time at their disposal in which to tell others what they are doing.

A writer in the United States treating of this subject, is then, in a sense, a pioneer and may with propriety beg for himself and for his book the consideration and the allowances usually conceded to pioneers in all fields.

While the main foundations of accounts are identical throughout the world, and it is, for example, as unwise in Finland as in Florida to anticipate profits or to allow a fictitious valuation of assets, the structures raised on these foundations may vary as greatly as do the winter quar-

ters of a Finn and those of a Floridian. Under these circumstances it is unavoidable that many of the instances and examples given in the following pages should be almost pointless outside of the United States, although the author has endeavored to present principles in a form so broad, and to give examples of a character so typical, that they may be of some service wherever real estate accounting is employed.

While no originality is claimed for the principles which are enunciated, the methods which are advocated, together with nearly all the forms presented, are the results of the author's personal practice; no merit, however, is claimed for the fact that they have originated with him and have not been "compiled" from other sources, the simple reason for this being that he has been unable to find any sources from which it was possible to compile.

Special attention is given to the treatment of "time sales," and the procedure described is original and is developed to a greater degree than has been general. The rapid growth of "development" companies, the lack of uniformity, and the frequent disregard of the principles involved, all combine in calling for a rather full treatment of this interesting branch of the subject.

Legal questions will frequently arise in connection with real estate accounting, and to a lawyer the legal statements of the present volume may appear meager and crude. The author has, however, attempted to give merely such explanations of these matters as are necessary to enable the real estate accountant to make his entries intelligently and in conformity with legal requirements.

No attempt has been made to give examples of the various legal forms employed in connection with real estate, such as deeds and contracts. They already occupy much space in many volumes; and the general usefulness of

such a collection, unless it is complete, is impaired by the fact that the forms, while perhaps excellent for Illinois, for example, may utterly fail to comply in some essential with the statutory requirements of other states.

The object of bookkeeping is to show not only the results obtained by an enterprise, but also the *causes* of these results — not only to exhibit a gain or a loss, but to show whence came the values gained, or whither went the values lost. The very form of a trading statement or of a profit and loss account shows on its face that this is the object of its existence. But while the truth of this statement is generally acknowledged, many accounts may still be found which fail, in this respect at least, to justify their being.

In real estate accounting, where each item of the inventory has an individuality entirely lacking in the case of merchandise or manufactured goods, both cause and effect may be shown with unusual clearness. In the present work this fact has been kept constantly in view, and the methods of accounting presented will be found to show clearly at all times both the results and the reasons therefor — even for a single lot of a large subdivision.

The present work is intended primarily for the use of accountants, but, inasmuch as it is designed also to be of practical service to the real estate manager, the bookkeeper, and the student, considerable space is devoted to details with which accountants are already familiar. It is assumed, of course, that all those who use this volume have at least a rudimentary knowledge of double-entry bookkeeping.

It may also be said that real estate is so closely related to a large variety of enterprises which are not primarily concerned with real estate, that a study of real estate accounting proper involves some knowledge of these other businesses. While, therefore, the present volume is devoted to real estate accounting, digressions have at times seemed

necessary, in order to explain particular points of contact with other kinds of business.

While the author believes that the theories presented and the practice outlined in the present volume are sound, his readers will doubtless discover matters of importance which have been omitted, and other matters which are not presented as clearly as they might be. Suggestions looking to a betterment of the book in any way will be received with gratitude, and will be utilized in the preparation of subsequent editions.

The author's fairly wide professional experience convinces him that one suggestion may not be entirely out of place. A patient might read treatises on the disease from which he suffers, but he would consult a physician to prescribe the remedy; and a wise land owner about to erect an office building would secure all the information on the subject obtainable, but he would engage an architect to draw the plans. In the same way, it is to be hoped that the manager of a real estate concern will not, when important accounting matters of a technical nature are on hand, trust solely to any treatise on real estate accounting, but will seek the assistance of a trained and qualified accountant.

WALTER MUCKLOW.

Jacksonville, Florida,
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Real Estate Accounts

CHAPTER I

DEFINITIONS

§ 1. Definitions of Terms

Before dealing with real estate accounting, it is necessary to understand clearly what constitutes "real estate." The Century Dictionary gives the following definition: "Land, including with it whatever by nature or artificial annexation inheres with it as a part of it or as the means of its enjoyment, as minerals on or in the earth, standing or running water, growing trees, permanent buildings, and fences."

Buildings, orchards, mines, etc., are therefore real estate and should be shown as such. It is not uncommon to find under the head of assets such an entry as—

Real Estate.....................	$........
Buildings (or Improvements)....	....

This is incorrect, and should be of the form:

Real Estate:	
Land	$........
Buildings	....

In the present work, for the sake of brevity, uniformity, and clearness, the following words and phrases are used with the limited meanings given. It will, of course, be un-

derstood that these limitations are purely arbitrary, and apply only to the use of these words and phrases in this book. This is especially true in regard to the terms "gains" and "profits," which are usually synonymous and interchangeable.

1. *Contracts.* This term is always applied to any kind of lease or agreement providing for the sale of real estate on an instalment plan.

2. *Gain; Gain on Sales.* These expressions are used to indicate the gross gain on sales, or book profits on transactions, in which the payment of the full purchase price is deferred and the profit has therefore not been fully realized. Such "gains" are not available for dividend-paying purposes until they have become "profits."

3. *Profits; Realized Profits; Earned Profits.* These terms are used to designate "gains" that have been earned or realized—gains that may be carried to the Profit and Loss account as distinguished from those which are sometimes called "book profits."

4. *Time Sales.* In this classification are included all sales which are not paid for in cash or its equivalent—sales in which the purchaser is allowed time for the completion of the payment for the property. They are also known as sales "on the instalment plan," "on deferred payments," etc.

5. *Subdivision Properties.* This term is used to indicate such properties as consist of a number of lots or farms, these together forming a whole tract. Such properties are also known as "allotment," "development," "suburban," etc., properties.

6. *General Contracts.* This classification is intended to include contracts given by the concern on properties other than subdivision properties, which frequently require more detailed accounting than subdivision contracts.

7. *Contracts Payable.* This term applies to contracts entered into by the concern for the purchase of property. They are therefore the reverse of the contracts considered under (1) on the preceding page. Contracts payable vary in form to meet the circumstances. While they may not carry any obligation to complete the purchase, and may be therefore in the nature of a contingent liability, they differ from the obligation toward the owner under a "selling contract," inasmuch as all payments made by the concern are forfeited if the contract payable is not completed.

8. *Selling Contracts.* By this term is meant a contract giving the concern the right to sell certain property owned by another, the title, as a rule, not passing through the concern.

9. *The Concern.* This term is used to designate the proprietor of the accounts under consideration; it may be a corporation, a partnership, or an individual acting either for himself or in a fiduciary capacity. In some cases "the concern" is an owner; in others, merely a broker or agent; so, as a matter of convenience, the word "concern" is used to cover all cases.

CHAPTER II

RECORDS FOR REAL ESTATE

§ 2. Records Required

To record properly all transactions arising in connection with real estate, a considerable number of books and forms must be provided. No one concern may need them all, but they are treated here to provide for the varying conditions and requirements of the real estate business.

In a large business, such as that of many land development companies, the books will be numerous, for efficient management requires that the business be regarded from many standpoints. The more important activities of such a concern may be roughly classified as follows:

1. The management of its capital and the recording of all items relating thereto.
2. The collection of income arising from the operations of the business, and the proper entering thereof in the books of account.
3. The proper recording of each piece of property in which the concern has *any* interest.
4. The recording of all sales, with full details in each case.
5. The keeping of an account with each debtor to and creditor of the concern.

§ 3. Use of Records to Officers

It not infrequently happens that there are several officers in a real estate company, and perhaps several committees, each looking at the affairs of the concern from a

different standpoint and requiring different information. This necessitates the keeping of accounts in such detail and yet in such clear form that they may be readily understood by each of the interested parties. Under such circumstances its records must be arranged to fill the following requirements at all times and on short notice:

1. To keep the manager of the business informed as to its general condition.
2. To inform the treasurer as to his current resources and liabilities, and particularly as to approaching liabilities, such as notes becoming payable, insurance to be renewed, taxes to be paid, etc.
3. To show the collection department the standing of each debtor.
4. To inform salesmen fully as to all unsold properties.
5. To show on the face of each account in the property ledger the cost to date of the property to which the account pertains, and to show in their appropriate places the costs of all other securities owned.

§ 4. Loose-Leaf and Card Records

Except in the cases of the few general accounts specified below as requiring bound books, the larger part of the real estate records may be most conveniently kept in loose-leaf ledgers or on cards. In some few cases, as for instance, insurance records (see § 330), the loose-leaf ledger is much to be preferred to cards, for two main reasons:

1. There is less likelihood of loss and confusion when accounts are to be consulted.
2. It requires far less space.

Take for example a sub-ledger for a subdivision tract

with 750 customers, to which frequent reference is made by the bookkeepers, by the credit man, and by a number of salesmen. The examination of one of these accounts, if they are kept on cards, usually necessitates the removal of that card from the file, and, unfortunately, these cards are not always returned promptly. It is perhaps kept out for reference, for correction, or for copying; other matters intervene, its return is postponed indefinitely, and the card too often is lost.

In the case of a loose-leaf ledger, on the other hand, an account to be consulted is found in the ledger; a slip may be inserted to mark the sheet, but the account itself never leaves its proper place.

Again, who has handled card records in any quantity without seeing at least once a file full of cards dropped or upset, requiring hours, perhaps, to sort out and rearrange?

As to compactness, the space required for 750 cards is several times greater than that required for the same number of ledger sheets, especially if the latter are of thin paper. A number of such ledgers containing thousands of accounts can be kept in an ordinary safe, while an equal number of cards require a special series of filing cabinets and more vault space than can as a rule be conveniently given.

§ 5. List of Real Estate Records

The following list is intended to include the more important books and records required in the many ramifications of the real estate business. The list looks formidable, and in practice no office, save perhaps a few of the largest, would use them all. All are needed, however, somewhere, at some time, to record adequately the numerous and varying transactions of real estate.

1. Corporate Records:
   - Minute Book
   - Stock Certificate Book
   - Stock Record or Stock Ledger
   - Subscription Ledger
2. General Books of Account:
   - General Receipt Book
   - Cash Book
   - Petty Cash Book
   - Superintendent's Cash Book
   - Journal
   - General Ledger
3. Sub-Ledgers:
   - Mortgages Receivable Ledger
   - Mortgages Payable Ledger
   - General Contracts Ledger
   - Commissions Payable Ledger
   - Brokerage (Commissions Earned) Ledger
   - Subdivision Customers Ledgers
4. Property Records:
   - Report of Real Estate Transactions
   - Property Index
   - Property Ledger, Wild Lands
   - Property Ledger, City Lots
   - Field Record, City Property
   - Field Record, Wild Lands
   - Subdivision Tickler
   - Plat Book
   - Record of Deeds Received
   - Record of Deeds Issued
   - Record of Contracts Issued
   - Record of Options Granted
   - Subdivision History

5. Rent Records:
    Record of Leases Given
    Rent Register (House Address Book)
    " Receipt Book
    " Reports
    " Cash Book
    " Journal
    " Ledger

6. Miscellaneous Records:
    Fire Insurance Record
    Bills Payable Book
    Bills Receivable Book
    Mortgage Interest Receivable Record
    Mortgage Interest Payable Record
    Expense Account Analysis Book

§ 6. Separate Books for Each Class of Accounts

The idea sometimes prevails with those unfamiliar with accounting that the simplicity of an accounting system may be measured by the number of books employed—an idea which is frequently fallacious. The simplest system is the best, if it is adequate; but speaking generally, nothing could be more mistaken than the idea that simplicity and the number of books employed have any necessary connection. Simplicity is frequently attained by keeping different classes of entries in different books, rather than by entering many varied transactions in one book, a method which necessitates much analysis at a later day.

The terms "a few records" and "simple methods" are not synonymous; they are in fact opposed to each other. "Few records" usually mean poor records, and poor records not infrequently result in a poor owner of those records. In the case of a large real estate business with nu-

merous branches and much detail work, a certain complexity is unavoidable. It is a condition common to all affairs that the larger and more involved the business, the more comprehensive and complex must be its system of records.

Also in any business, no matter what its size, a sufficient number of books must be employed to record properly its transactions, and the accountant when installing a system, usually finds that simplicity and clearness are obtained by the use of records sufficient in number to keep each class of entry separate and distinct.

§ 7. Condensed Records

Several decades ago there was an unnecessary amount of writing caused by the multiplicity of day-books, the needless journalizing of every entry, and useless transcriptions from book to book. It was discovered that much of this was duplication, still more was needless, and that much elimination was possible. A reaction set in; the pendulum swung to the opposite extreme, and all kinds of condensed systems and combinations were devised, copyrighted, and patented, but have in most cases been abandoned. One enterprising retailer whose small business allowed him ample leisure, even devised a single book which was to take the place of journal, cash book, and ledger. It required no balancing, and in fact was a whole accounting system in itself. Most accountants who have audited such a method when applied to a large concern and where carelessness has existed in the bookkeeping, will testify to the troubles involved by such attempts at simplicity. It must not be gathered from this, however, that columnar books are to be condemned. On the contrary, they are invaluable, but they must be designed and used with judgment.

In considering the number of records it must be remembered that competent accounting calls for no word and no

figure beyond those actually necessary. Each transaction must be entered, and be entered clearly, but no more time is required to make these entries in a properly designed series of books than to crowd them into a single volume, which, if the business is large, must necessarily assume clumsy proportions. Also, it is obvious that reference to a set of books in which the entries are properly classified and displayed will be easier and much more satisfactory than is possible under the limitations of a single-volume system.

CHAPTER III

CORPORATE RECORDS

§ 8. Minute Book

The minute book is of the first importance among corporate records, for it is usually the original and sole record of the proceedings at corporate meetings. It also contains copies of both the charter and the by-laws. These, however, as a rule are only copies and could be replaced; while the minutes do not appear elsewhere and could not be duplicated if the minute book were destroyed.

In the case of a real estate company the minutes are particularly important, as the business itself is peculiarly fertile in special resolutions and authorizations. For this reason it is perhaps well to insert a word of caution as to the use of loose-leaf minute books. The minute book, and usually the minute book alone, contains the final authorization for all important transactions approved by the directors. Considering the probability of changes in the board of directors, and the fact that the minutes are perhaps written by different individuals at different times, and that it may be necessary to refer to them years after they have been made, the wisdom of confiding such important records to loose sheets is obviously doubtful, unless every precaution be taken to prevent loss, change, or substitution.

The loose-leaf minute book has many attractions. It is convenient; it enables minutes to be typewritten; a duplicate copy may be made if desired; and it presents a better appearance than the ordinary book. These advantages, however, do not warrant the use of the book so long as any

page can easily be removed without detection, and it should not be used unless it is of a style that makes removal or substitution of leaves difficult if not impossible. This end is sometimes attained by the use of a special paper, each page having its proper folio number printed on; sometimes by numbering and initialing the pages as they are written; or, still more effectively, by watermarking the page numbers or some private emblem into the sheets when the paper is made. In the case of the numbered pages, every sheet must be accounted for and substitution or change will be quite as difficult as in a bound book.

§ 9. Stock Certificate Book

The form of the stock certificate book and the general design of its certificates vary but little. The matter appearing on the body of the certificates is determined by custom or by the statutes of the state in which the corporation is organized. The essential requirements are that each certificate shall show the name of the company, the state in which it is incorporated, the total authorized capital, the name of the owner of the certificate, the number of shares which the certificate represents, the value of each share, the nature of the stock—whether common or preferred—and the date of issue. The certificate should also provide a blank form of transfer for the owner to use when his stock is to be assigned.

The certificates, which are usually in a bound volume, are numbered consecutively and have stubs numbered to correspond. These stubs contain blanks for recording the most important data given on the certificate.

The stock certificate book is usually kept by the secretary of the corporation. No difficulty is likely to be encountered in keeping it, provided the necessary entries are made at the time each transaction occurs. It is, however,

of the greatest importance that no certificate be issued until the essential facts have been entered on its stub. When a certificate is surrendered for reissue, it should be cancelled by perforation, by a rubber stamp, or by some other method equally effective. It should then be pasted back on the stub of the stock certificate book from which it was originally torn, and there should be entered on this stub the number of the certificate issued in lieu thereof, or, if none is issued, the reason for its surrender.

These matters appear almost too elementary to dwell upon, and yet a vast amount of labor and trouble may be, and frequently is, caused by the failure of the secretary or bookkeeper to make the proper entries at the proper time.

Stock certificates are occasionally printed and kept loose, that is, not attached to any stub or bound in a book. Such a course is unwise and unsafe.

§ 10. Stock Record or Stock Ledger

This is really a sub-ledger, in which an account is opened with each stockholder, charging him with certificates issued to him and crediting him with those which he has surrendered. (See Form 1.) Inasmuch as the stubs in the stock certificate book constitute a bound volume from which entries are made into the stock ledger, the latter record is not one of original entry. It is therefore safe and entirely proper to use a loose-leaf book for this ledger without the precautions necessary in the case of a loose-leaf minute book. The loose-leaf stock ledger is usually arranged alphabetically, thereby saving all reference to an index. If the company is a large one, there is considerable advantage in this alphabetical arrangement. In some states the alphabetical arrangement is required by law. The fact that accounts can be removed as they are closed is also an important feature of the loose-leaf ledger.

SHEET NO. ____________

NAME

ADDRESS

NOTE: ALL ENTRIES IN RED INK ARE CONTRA.

	DATE OF ISSUE			DATE OF CANCEL			NO. CERT. ISSUED	NO. CERT. CANCELLED	NO. CERT. RE-ISSUE	FOLIO	To or From WHOM TRANSFERRED	NO. SHARES CONTRA	NO. SHARES		
	Mo.	Day	Year	Mo.	Day	Year							Issued	Surr'd.	Balance

REMARKS:

Form 1. Capital Stock Ledger

§ 11. Subscription Ledger

This book is needed only where capital stock is not paid for immediately upon subscription. In it, an account is opened for each subscriber for stock, showing his name and address, the amount of his subscription, and the terms of payment. The subscriber's account is charged with the amount of his subscription, and credited with the payments thereon as they are made. When the subscription is completed the account is closed. Inasmuch as this is merely a sub-record, the entries for which are taken from the journal and the cash book, the loose-leaf ledger is convenient and unobjectionable. The subscription ledger corresponds to the English record known as the "call book," in which is recorded each call made for unpaid capital subscribed.

The debit entries to the subscription ledger are posted from the journal, where the entry is usually made in the following form:

Subscription Account.....................	$........	
To Capital Stock Account...........		$........
For the following subscriptions to stock:		
John Brown, 5 shares, $500, payable		
James Smith, 10 shares, $1,000, payable		

The credit entries to the subscription ledger are usually posted from the cash book as payments are made, although occasionally a journal entry is required when some consideration other than cash is received for capital stock or when subscriptions are cancelled.

CHAPTER IV

GENERAL BOOKS OF ACCOUNT

§ 12. General Receipt Book

It is essential that every item of cash received should be immediately entered on the records, and the best method of accomplishing this is to use a receipt book in which the receipts are numbered consecutively in duplicate, the second copy being made out at the same time as the original by means of carbon paper. There can be no doubt that the carbon duplicate in such book is far better than the receipt stub. Not only does it save time but it gives an absolute duplication of the receipt delivered to the party making the payment.

The original of each receipt in the general receipt book is perforated so that on being made out it can be torn from the book and given to the payer, the duplicate (preferably on colored paper) remaining in the book. The receipt book then forms the book of original entry, on which all subsequent entries relating to cash received are based. This book takes the place of a cash "blotter" or counter book for receipts, and in the temporary absence of the regular cashier provides his substitute with a convenient and reliable means of accounting for all money he may receive.

It is a good rule, and in large offices an essential one, that all receipt books shall be kept by the cashier or other responsible officer under lock and key, and that new books be issued to collectors and others only as the old books are returned. A written record should be kept of the date of issue of each book and the name of the person receiving it.

It is convenient to paste on the back of each book its number, and the first and last dates of all the receipts it contains.

The used receipt books must be filed with care, for in the event of a controversy over any payment they are, as books of original entry, of even more value than the cash book itself.

THE ALPHA LAND COMPANY

NOCATEE, GEORGIA

No. 72457 ....191..

Received of..

Address ....

....

The sum of..

....

ON ACCOUNT OF

Mortgage No.............Principal.................... $............

Interest.................... $............

Contract No.................................... $............

Eureka Gardens................................ $............

Fairmount .... $............

Grandville .... $............

Kingslake .... $............

Ladore .... $............

.... $............

.... $............

THE ALPHA LAND COMPANY,

$............ By...................

(This receipt made in duplicate)

Form 2. General Receipt Book

The form of receipt book shown in Form 2 has been in actual use for a number of years and meets every general requirement. Receipts for rents are given on a different form.

Speaking generally, every penny of cash received should be accounted for on a receipt. In practice there arise a few exceptions to this rule, as for instance, proceeds of discounted notes, proceeds of bills payable and of mortgages and bonds sold. Even in such cases it is, when possible, usually advisable to fill out a receipt showing the details, although the original receipt is not necessarily delivered to the person from whom the money is received.

§ 13. Cash Book

In modern practice it is customary to speak of the cash book as distinct from the journal, and this naturally leads those unfamiliar with bookkeeping to think that some radical difference exists between the two books. This, however, is not the case, for a cash book is neither more nor less than a special form of journal devoted to cash entries, and might, therefore, properly be called a cash journal, just as a journal devoted to sales entries is called a sales journal.

In practice, the term "Cash Journal" is usually restricted to the columnar form of cash book, an example of which is shown in Form 3. The use of this name has caused some confusion and has sometimes been made an excuse for bringing into this record items which do not refer to cash. Considered in the light of accounting history, this practice is a step backward rather than forward. Our forefathers brought the record of all their transactions into one book—a journal, i.e., a "day-book"—from which they posted to the ledger; but after years, centuries in fact, it was found advantageous to eliminate cash items from the journal and record them in a cash book. This idea has

CASH RECEIPTS

DATE		FOL.	MORTGAGE PRINCIPAL	MORTGAGE INTEREST	CONTRACTS	RENTS	EUREKA	FAIRMOUNT	MISC.	BANK DEPOSITS	

CASH DISBURSEMENTS

DATE		FOL.	EXPENSE	REPAIRS	COMMISSIONS	MORTGAGE INTEREST	INTEREST & DISCOUNT	MISC.	BANK CHECKS

Form 3. General Cash Book

been further developed and expanded until today we find cash journals, sales journals, purchase journals, and many others. It should be observed, however, that all such books have one aim in common, namely, to start the work of analysis as entries are made, and thus segregate each distinct class of entry in an appropriate record. Whenever a departure is made from this principle and entries relating to all kinds of transactions are crowded into one record, we are clearly returning to those methods which science and experience have taught us should be abandoned.

The actual form of cash book used in any particular instance must depend upon the nature of the business. There are, however, a few rules which apply in almost all cases. One of these requires that the cash book be a bound book and not of the loose-leaf form. A dishonest cashier may, of course, make changes in a bound book, but it presents more difficulties than a loose-leaf book, and gives the auditor a far better opportunity of discovering any irregularity and particularly any carelessness on the part of the cashier which may have occurred.

There is one exception to the rule above mentioned, which applies to a concern that has two offices at different points, as for example, an English concern which operates both in England and in the United States. In such a case the home office frequently desires a monthly transcript of the cash book, and it is then entirely proper to have the cash book in loose-leaf form, arranged with duplicate pages, printed on thin paper, and ruled on one side only, so that by the use of carbon paper the alternate sheets give a copy of the original writing. This is easily secured by the use of the typewriter or of a hard pen, and it saves the labor of rewriting the entire cash book. At the end of each month the duplicate sheets are taken out and sent to the home office. They then pass beyond the control of the bookkeeper,

and should any question involving them arise in the future, they are always at hand for reference.

Another general essential for the cash book is the use of special columns. It is almost invariably found that such a book is most convenient for the bookkeeper, the management, and the auditors. The number of columns depends, of course, upon the nature of the business, the main point being that every account which is used often should have a column allotted to it, as indicated in Form 3.

In the case of a large company handling a considerable number of active subdivisions, it is often convenient to have a cash book containing forty or fifty columns. It is then advisable to enter the receipts in one volume and the payments in another—an arrangement which presents many advantages, as two bookkeepers can work on the books at the same time, and the auditors can examine one volume without interfering with work on the other.

The cash book should be written up and balanced each day, the debit side being entered from the receipt books, and the credit side from the check stubs, check register, or voucher list.

The rule that all incoming cash items be entered at least daily, should be invariably observed, and the *total cash received should be deposited in the bank each day.* In this way the cashier is at once relieved of all further responsibility as to the custody of that particular cash, and the auditor can very quickly check each day's receipts with the amount shown in the bank pass-book. This is probably the most important of all rules for the keeping of cash books.

On the credit side of the cash book are entered the disbursements, all of which should be made by check. Small items are paid out of the petty cash, which is described in § 14.

When such a cash book as is shown in Form 3 is used,

each of the bank accounts is kept in it, and no cash or bank accounts need be kept in the ledger (except occasional or special bank accounts outside the usual current business), the cash book balance being carried direct to the trial balance. A fastidious bookkeeper may claim that the ledger should show each and every account, and for the sake of completeness may add a cash account to his ledger, the total receipts and disbursements being posted once a month. Such a ledger account has the advantage of furnishing a statement of monthly receipts and disbursements, which is sometimes of value.

It may be noted that one of the chief objects in having the bank column in the cash book is to avoid the necessity for a check register. With the cash book so arranged, and a good system of voucher checks, either in duplicate or with stubs, the register may safely be dispensed with.

It is not an uncommon practice for agents who sell properties, especially subdivision properties, to deduct their commissions from the remittances they make to the home office. In an office where many such transactions occur, it is convenient to use a column on the debit side of the cash book in which to write such deducted commissions. If this is done, the two amounts — cash received and commissions — should be credited to the customer; and at the end of the month the total of the commission column must be treated as a journal entry and *debited* to Commission account, being omitted, of course, from the cash book totals of receipts. This method is similar to that followed by many mercantile houses in connection with the discounts allowed to customers.

It is a better practice to have the agent remit his collections in full and receive a check for his commissions; but the enforcement of such a rule in face of an established practice might handicap the selling force.

§ 14. Petty Cash Book

As already stated, all payments entered in the general cash book must be made by check, and as in every office there are sundry disbursements too small to justify separate checks, some proper means of making these must be provided.

The usual and proper method of handling such payments is through a petty cash account maintained on the imprest system. The method of keeping this is simple. To open the account, a check for a round sum sufficient to care for such expenditures for a month or other convenient period, is given to the cashier and is charged on the general ledger to "Petty Cash" or "Imprest Fund." This ledger account remains unchanged unless the amount of the fund in the hands of the cashier be increased or diminished.

PETTY CASH

	DATE	NAME	EXPENSE	REPAIRS	COM-MISSIONS	POSTAGE	ADVER-TISING	MISCEL.
		TOTALS-MISCEL.						$
		ADVERTISING					$	$
		POSTAGE				$		$
		COMMISSIONS			$			$
		REPAIRS		$				$
		EXPENSE	$					$
		GRAND TOTAL-PAID BY CHECK	NO......					$

Form 4. Petty Cash Book

This is so because, as explained later, subsequent checks drawn to replenish petty cash are not debited to Petty Cash account, but are charged directly to the various accounts for which the petty cash funds have been expended.

From this petty cash fund the cashier makes such payments as are necessary, recording each one in a book similar to that shown in Form 4. Before the entire amount is expended, he casts up each of the columns and finds the total of his expenditures; a check is then drawn for this exact amount, and the cashier again has the original sum with which he started and can repeat the whole process. The check itself is entered on the cash book and divided among the various accounts to which it is chargeable, as shown by the columns of the petty cash book.

It will be noticed that Form 4 differs from the usual form of cash book in that it records disbursements only. This is owing to the fact that after the initial check is drawn for petty cash, each succeeding check is for the exact amount of the expenditures up to a given point, and whenever petty cash is thus replenished by a check from the general cash account, the petty cash book is ruled off and a notation made, substantially as follows:

Total Disbursements............. $........
Covered by
Check No........ Date..................

The distribution headings shown on Form 4 are not printed as their position cannot be determined in advance, but are written in whenever the columns are totaled.

It is an excellent practice to provide the cashier with petty cash vouchers, as shown in Form 5, printed on inexpensive paper and bound in pads in the same manner as are the debit and credit slips in a bank. The used vouchers can be filed in bundles, each one of which should repre-

sent the disbursements covered by one of the checks from the general account.

AJAX LAND COMPANY

PETTY CASH
VOUCHER

JORDAN, N. C.,..................191..

Received of the Cashier..

.... Dollars

For ....

....

....

Form 5. Petty Cash Voucher

§ 15. Superintendent's Cash Book

It is frequently desirable that a superintendent or resident manager whose headquarters are distant from the head office, be furnished with funds to meet current expenses. If the amounts he expends are large, he should make his payments by means of checks on a special bank account. If they are small, he may make them in currency, as suggested in connection with the management of petty cash.

A superintendent's account should be kept, as far as circumstances permit, on precisely the same lines as the cashier's petty cash, and a similar record is therefore appropriate. Inasmuch as the superintendent must render to the chief office a report of his transactions, it is convenient to have his book printed with the alternate leaves perforated so that they may be detached; and by means of carbon paper, those sheets remaining in the book can be made to show a copy of each report sent to the head office. Experience has shown that unless some such method is followed,

the cash account of the superintendent may easily become confused and thereby entail the waste of much time.

Whatever system be followed for recording the disbursements of a superintendent or resident manager, it will be found wise to establish the rule that any collections he makes must invariably be remitted intact to the main office, and never allowed to become a part of, or to be in-

REPORT OF CASH RECEIVED AND EXPENDED

BY THE SUPERINTENDENT AT ____________________

DATE	RECEIVED	AMOUNT	DATE	EXPENDED	VO. NO.	AMOUNT
	TOTAL RECEIPTS SUBMITTED HEREWITH			TOTAL EXPENDITURES PER VOUCHERS HEREWITH		

TO BE CREDITED TO: ____________________

TO BE CHARGED AS FOLLOWS: ____________________

Form 6. Superintendent's Cash Book

cluded in, his petty cash; for if they are, the necessity for journal entries will arise, whereas all these cash transactions should be recorded on cash books.

When a superintendent receives and disburses cash, as already suggested, a uniform style of report (Form 6) should be adopted. This, as stated, should be arranged so as to provide, by means of carbon copies, an original for

transmission to the principal office and a duplicate to be retained by the superintendent.

§ 16. Journal

Inasmuch as the journal is a book of original entry, and contains entries vitally affecting nearly all sales and purchases, the book should be permanently bound and not of the loose-leaf form. The number of columns must depend somewhat upon the requirements of the particular case, but as a rule at least four columns should be provided, and frequently it is a convenience to have six or more columns. In connection with the accounts for subdivision properties, the columnar form of journal presents advantages so great as to render it practically indispensable for the proper entry of contracts and the entries relating to the cancellation thereof.

It is a common practice in offices handling such properties, to reserve in the journal on the first of each month a page or other appropriate space for each subdivision, inserting merely the heading, e.g.:

Kingslake Contracts...........................	$........	
To Kingslake Purchase..................		$........
" Kingslake Gain......................		....

From time to time during the month, as contracts are made, they are entered in columnar form, as follows:

	Contracts Dr.	Purchase Cr.	Gain Cr.
J. Doe, #182	$250.00	$200.00	$50.00
R. Roe, 183	500.00	400.00	100.00

At the end of the month these columns are added and the totals inserted in the headings.

In the case of cancellations the form of entry may be:

Real Estate..........................	$........		
Gain	....		
To Contracts		$........	
" Cancellation Profits............		....	

In this case, four columns would be required.

It is obvious that this form of entry requires less labor, and gives a record better adapted to quick reference, than if each contract were made the subject of a distinct journal entry.

§ 17. General Ledger

Inasmuch as in a properly designed system the number of accounts in the general ledger is small compared with the total number of accounts, a bound book can often be conveniently used. In the case of a large concern it is, however, usually advisable to use a loose-leaf book, particularly as certain accounts contain numerous items and it is almost impossible to predict how many folios they will cover.

The loose-leaf ledger is no more likely to lead to errors of carelessness than a bound book, and any bookkeeper capable of wilfully falsifying his books could do so with almost equal ease under either system. In many offices efficient safeguards can be provided by a properly arranged system of internal checking, the ledgers and cash books being kept by different bookkeepers who are occasionally changed from one book to another. An additional security is furnished when each sheet is initialed by an officer of the concern at the time the account is opened, and the rule enforced that no sheet may be removed until again initialed. If the books are subject to the audit of an accountant, the periodic initialing of balances and checking of items render any substitution still more difficult.

Whichever style of book is chosen, the ledger shown in

Form 7, which differs somewhat from that generally used, is strongly recommended. This form of ledger greatly aids in the preparation of monthly trial balances, and also facilitates the analysis of any account at any time.

In real estate accounts particularly, it is often desirable

LADORE EXPENSE

DATE			ITEMS	MONTHLY TOTALS	DATE			ITEMS	MONTHLY TOTALS
1917 Jan.	17	Surveying	$ 15.00		1917 Jan.	25	Old Lumber	$ 5.00	
	20	Grading	20.00			31	Refund labor	2.00	$ 7.00
		Advertising	45.00						
	31	Grading	15.00	$ 95.00					

Form 7. General Ledger

to find out how the monthly sales of some one subdivision have been running during a given period, and a glance at such a ledger shows this without further calculation. In a concern doing a large business, there is frequently a very short interval between the closing of the books and the preparation of the annual report, while at the same time there is an unusual amount of work in connection with the calculation of realized profits. Every hour saved in such work is of great value, and the advantages of this form of ledger are then manifest.

CHAPTER V

SUB-LEDGERS

§ 18. Mortgages Receivable Ledger

This is a sub-ledger intended to show all the particulars of every mortgage held by the concern. (See Form 8.) It is of minor consequence whether it be a bound book or a loose-leaf ledger, as the mortgages may be entered in the order of their serial numbers. The form of ruling adopted in either case should provide for the exhibition of the following facts:

Serial number of mortgage; name of mortgagor; description of property and serial property number; amount of mortgage; date made; date due; value of security; rate of interest; dates when interest falls due; amount of insurance to be carried; details of notes — number, due dates, etc.; particulars of the recordation of the mortgage; profit.

Rulings should also be provided for a "Principal" account and for "Interest and Charges."

The mortgages receivable book shown in Form 8 meets the above requirements, and in connection with the property ledger gives all necessary information regarding mortgages receivable.

As soon as a mortgage receivable — that is, a mortgage given to or acquired by the concern — is executed and delivered, it should be entered in this book under the first vacant serial number. For instance, if the first of such mortgages were made by Alfred Jones, it would be known in the accounts as "Mortgage Receivable No. 1—Jones."

Inasmuch as precedence among several liens upon the

AMOUNT $			MORTGAGE RECEIVABLE NO.
DATE MADE	DATE DUE		MADE BY
INTEREST	% PAYABLE		SUBSEQUENT OWNERS
VALUE OF SECURITY	INSURANCE		PROPERTY NO.
DETAILS OF BONDS OR NOTES			DESCRIPTION
RESERVE	RECORDED	COUNTY, BOOK	PAGE

			PRINCIPAL ACCOUNT				INTEREST AND CHARGES			
DATE			Debits	Credits	Dr. or Cr.	Balance	Debits	Credits	Dr. or Cr.	Balance

Form 8. Mortgages Receivable Ledger

same piece of property may depend very largely, if not entirely, upon the dates of their respective recordation, no time should be lost in sending each mortgage received to the proper recording officer; and when this is done a pencil memorandum of the fact should be made on the mortgages receivable ledger. When the mortgage is returned, the full particulars of its recordation should be entered in this ledger and the mortgage itself should be filed in its proper place.

In the mortgages receivable ledger, each Principal account is debited with the original amount of the loan and credited with each payment on account of principal as it is made. The total balances of these columns of the sub-ledger must therefore agree with the balance of the Mortgages Receivable account in the general ledger.

It is frequently convenient in determining action regarding mortgages (for instance, when a mortgage is in arrears), to know the amount of profit in the original transaction. A place for this information is therefore provided in the mortgages receivable ledger under the heading "Reserve," this saving reference to the journal or other book in which the amount is recorded in the ordinary routine.

The Interest and Charges account of each mortgage is debited in the mortgages receivable ledger with interest as it falls due, and also with all expenditures for taxes, insurance, paving assessments, etc., paid by the concern but which are to be repaid by the mortgagor. The account is credited with money received from the mortgagor, or from other sources, in payment of these charges.

The total balance of the Interest and Charges account of the mortgages receivable ledger must equal the sum of the balances in the general ledger under the accounts Overdue Mortgage Interest Receivable, Mortgage Taxes, Mortgage Insurance, Mortgage Assessments, etc.

If it is intended that the lending of money on mortgage

shall form a distinct branch of the business, proper forms of application and forms for reports of valuers and inspectors should be provided. Properly speaking, these are not accounting forms and therefore are not discussed further in this volume.

§ 19. Mortgages Payable Ledger

This is a sub-ledger somewhat similar to that just described, but containing the particulars of all mortgages (entered in numerical order) which are payable by the concern.

A special form of ruling is required in order to show clearly the following facts:

Serial number of mortgage; name of the mortgagee or his assignee; description of the property, with serial property number; amount of mortgage; date of mortgage; date due; value of security; rate of interest; dates when interest falls due; insurance called for by the mortgage; particulars of the recordation of the mortgage. (See Form 9.)

Provision must also be made for keeping separately the Principal account and the Interest account, as in Form 8.

Where mortgages are made by the concern, all this information can be obtained direct from the original papers before they are delivered to the mortgagee. It is frequently the case, however, that mortgages payable are assumed by the concern as a part of the purchase price for property acquired, and in such cases abstracts of title must be relied upon for this information, which is to be checked against the statements of the mortgagors. (See §§ 52, 53.)

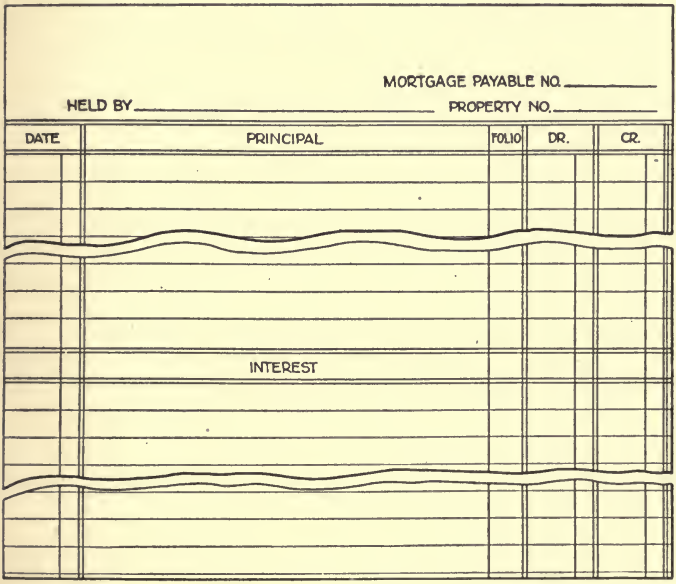
In the mortgages payable ledger the Principal accounts are credited with the amounts of the respective mortgages and are debited with payments made on account of the principal. The total of the balances must agree with the balance of the Mortgages Payable account in the general ledger.

AMOUNT $		MORTGAGE PAYABLE NO.
DATE MADE	DATE DUE	HELD BY
VALUE OF SECURITY		
INSURANCE		PROPERTY NO.
INTEREST %		DESCRIPTION
PAYABLE		
	RECORDED	COUNTY, BOOK PAGE

DATE		FOL.	DEBITS	CREDITS	DR. or CR.	BALANCE

Form 9. Mortgages Payable Ledger

It will usually be found that entries to the Interest accounts of mortgages payable relate solely to interest, and do not include such a variety of entries as appear in the corresponding accounts in the mortgages receivable ledger. This being so, the total balances of the Interest accounts will agree with the balance of the Overdue Mortgage Interest Payable account in the general ledger.


MORTGAGE PAYABLE NO. ________
HELD BY ________ PROPERTY NO. ________
DATE
PRINCIPAL
FOLIO
DR.
CR.
INTEREST

Form 10. Ordinary Ledger Ruling Adapted to Mortgages Payable Ledger

In the event that it is not desired to have so complete a record as Form 9 provides, a substitute may be arranged in any ledger-ruled book as indicated on Form 10; but if there is a great number of these mortgages, the more comprehensive form should be adopted. In passing, it may be well to mention that unusual liabilities are often incurred in connection with mortgages payable, and that the execution

or assumption of all such instruments should be authorized by the board of directors or other proper authority, the entries of which in the minutes may be compared with the entries in the ledger. The general subject of mortgages payable is discussed further in § 52 *et seq.*

§ 20. General Contracts Ledger

The sub-ledger known as the "General Contracts Ledger" should contain particulars of all those sales with deferred payments not secured by mortgage which do not belong to any special subdivision and which are known in this book as "general contracts."

The accounts in this sub-ledger may be arranged either alphabetically or numerically. The latter method is doubtless preferable, as it provides for a chronological arrangement and is uniform with the plan suggested for the mortgage ledgers. This method necessitates the use of an accompanying index, but as the employees usually designate transactions by their book numbers, reference to the index is seldom necessary. If the alphabetical arrangement is selected, a loose-leaf form of book is necessary; but for the numerical order either a bound or loose-leaf form can be used, the latter being preferable.

The legal papers in connection with such sales vary considerably in form; but whether known as leases, bonds for title, or similar name, they can be best considered for accounting purposes under a single head such as "Contracts."

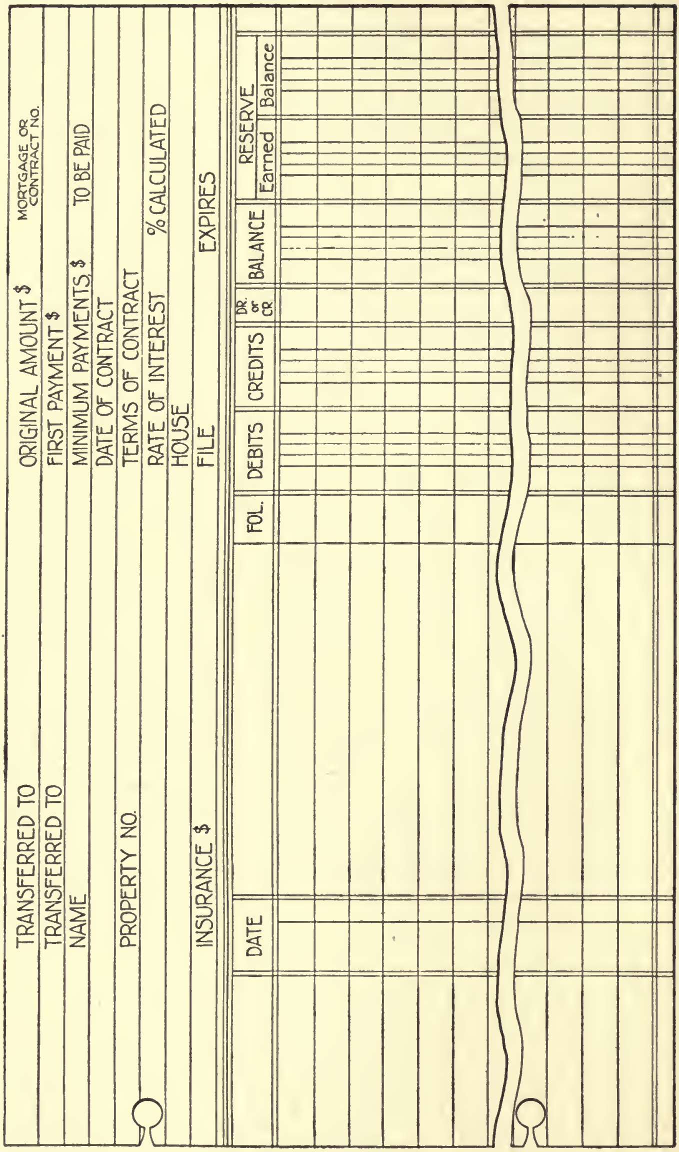
The general subject of contracts will be dealt with later (Chapter XVII), and at this point it is sufficient merely to enumerate the various items of information which should appear on the general contracts ledger. It is better, as a rule, to keep only one account for each contract, and to let that include the principal, interest, taxes, and all other

charges which must be paid by the purchaser before obtaining a conveyance of the title to the property which he has purchased.

The general contracts ledger, as will be seen by reference to Form 11 shown on page 38, provides for the following particulars:

1. Serial number of the contract.
2. Name of the purchaser.
3. Original amount, being the total purchase price.
4. Amount of the first payment (which is frequently considerably more than any of the subsequent periodic payments).
5. Amount of subsequent payments and their due dates.
6. Date of the contract.
7. Term of the contract (the number of years for which it is to run).
8. Rate of interest.
9. Dates when interest is to be calculated. (It is also well to note the date when the interest is payable, as it may be payable at fixed periods or it may be covered by the regular periodic payments.)
10. Street address of buildings on the property.
11. Amount of insurance called for by the contract.
12. Description of the property, with serial property number.
13. Profit.
14. Reserve.

Speaking generally, it is not the business of the vendor to see that contracts are placed on record; still, there is plenty of space in the heading of the ledger sheet shown in Form 11 to insert any notation which it may be desired to



Form 11. General Contracts Ledger

make should the purchaser have caused his agreement to be recorded.

In practically all cases contracts are brought onto the books of account through the journal. The amount of the original payment is in each case posted to the debit of its proper account in this sub-ledger, as are all subsequent payments for taxes, etc., made by the vendor, and all charges for interest; while money received on account of any contract, whether for principal or for interest, is posted to the credit of the appropriate account. The total of the balances of the general contracts ledger will therefore agree with the balance of the Contracts account in the general ledger.

The four principal forms of sub-ledger, viz., Mortgages Receivable, Mortgages Payable, Contracts, and Property, should be of uniform size, not only as a matter of general convenience, but in order that when desired they may all be kept in one set of covers, each sub-ledger under its own index.

§ 21. Commissions Payable Ledger

One of the minor difficulties sometimes encountered in a real estate office is the keeping of a simple and effective record of amounts paid to brokers or agents as commissions on time sales of the concern's property where the commission is paid as instalments are received from the purchasers. This difficulty becomes serious when there is a large number of such sales running at the same time. Form 12 will be found useful under such circumstances, especially in connection with commissions payable on options, etc. As will be seen, it is at once an option and commission ledger, but it is equally applicable to any time sale.

Name ________________ Lot ____ Block _____ Addition __________
Address ________________ Price $ __________ Amount of Option $ ____
Assigned to ________________ Contract $ ________ $ _____ per Month
________________ Commission $ _______ Pay to ____________
________________ Deed to ______________________

DATE	ITEM	FOLIO	AMOUNT	DATE	ITEM	FOLIO	AMOUNT	COMMISSION PAID

Form 12. Commissions Payable Ledger

§ 22. Brokerage (Commissions Earned) Ledger

The brokerage ledger is used for the purpose of recording all the transactions which yield a brokerage or a commission. (See Chapter XXX.) The record is a simple one and may be of the style shown in Form 13.

The profits arising from commissions on the sale of real estate are unusually simple. In the great majority of cases they are paid in cash or its equivalent as soon as a sale is completed, and are entered directly in the cash book or journal, as the case may be. In the matter of commissions on time sales, especially where the payments are small, it is a common custom for the owner to make some particular arrangement with the agent, such as agreeing to pay him, say, 50% of all collections until the commission is fully paid.

SHEET NO. ______ ACCOUNT NO. ______

NAME Palmer-Hays Loan

ADDRESS ______

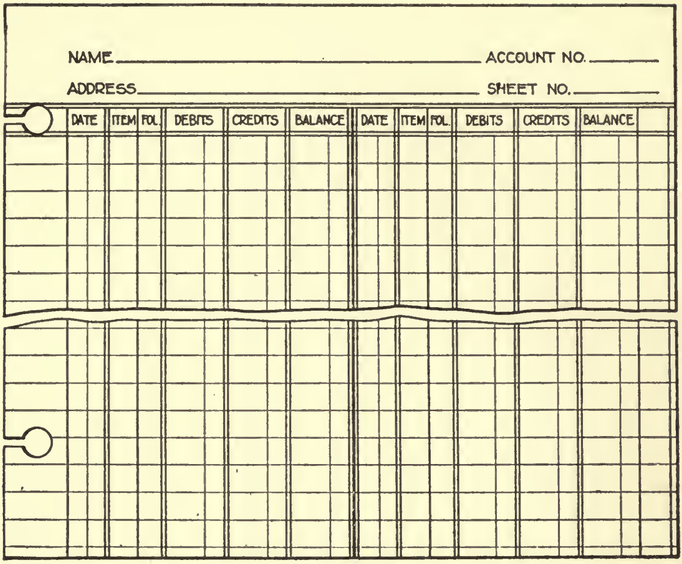
DATE		ITEMS	FOL.	√	DEBITS	DATE		ITEMS	FOL.	√	CREDITS
1916 May	10	Abstract	C90		$ 40 00	1916 June	2	Cash-Hays	102		$ 2000 00
	15	Atty Fee	C92		20 00						
		Appraisers Fee	C92		5 00						
June	2	Recording	C102		2 50						
		Commissions	J50		40 00						
		Palmer	C102		1892 50						
					$ 2000 00						$ 2000 00

Form 13. Brokerage (Commissions Earned) Ledger

§ 23. Subdivision Customers Ledgers

These sub-ledgers (Forms 14, 15, 16) contain accounts with individual purchasers of lots included in subdivisions handled by the concern (§§ 173, 174). If the concern buys a house, and then sells that house on contract, the account with the purchaser would be entered in the general contracts ledger (Form 11); but if the concern bought 1,000 acres of land and divided it into 500 tracts, the accounts with the various customers for each of these tracts would be kept in one of these subdivision customers ledgers, one such ledger being devoted to each subdivision.

Inasmuch as these accounts are of a somewhat temporary nature, frequently lasting not more than two or three years, it is not necessary to use so substantial a book as

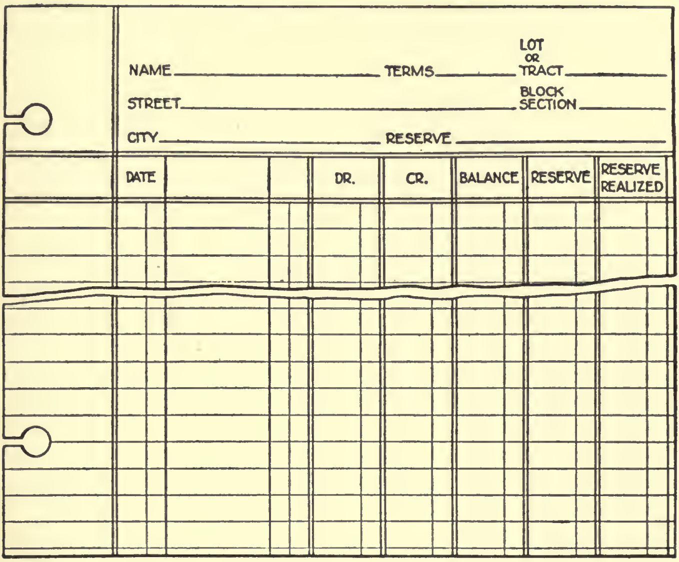


Form 14. Subdivision Customers Ledger

has been indicated for the preceding ledgers. Form 15, discussed in § 174, shows an improved method for keeping these accounts.

In some cases it is possible to use a tabular form of ledger not unlike the "Boston" ledger so largely used in banks. This form is well adapted to a comparatively small subdivision in which all the lots are disposed of by contract in a short time. In such a case each lot is entered in order of date on one line, or the names of the purchasers are entered in alphabetical order, an index being provided in the former case to show the name of each customer and the number of his contract. Form 16 shows the proper ruling.

By the use of "short leaves," a record of this kind extending over three or four years can be kept in a book of convenient size. The chief advantage of this form lies in



NAME ________ TERMS ________ LOT OR TRACT ________
STREET ________ BLOCK SECTION ________
CITY ________ RESERVE ________

DATE			DR.	CR.	BALANCE	RESERVE	RESERVE REALIZED

Form 15. Subdivision Customers Ledger

the fact that it dispenses with the necessity of drawing off a trial balance of the sub-ledger, as a total of the "Balance" column gives this at once. If any error has been made it can be quickly detected, for the total of the receipt column for any month must agree with the total of the corresponding column in the cash book plus any journal entries which may have been made.

Whatever the form of record used for these subdivision accounts, a fixed rule should always govern where contracts are transferred—a proceeding of frequent occurrence. In some offices it is the practice to write the name of the transferee on the existing ledger sheet, and then transfer this sheet to its location in alphabetical order; e.g., if a lot is bought by John Doe and an account opened with him, and this lot is sold to Richard Roe, the latter's name is written over Doe's, and the sheet transferred and placed under the

	NO.	NAME	LOT	BLOCK	PRICE	REC'D. JAN.	BALANCE	REC'D. FEB.	BALANCE	RE M
	1	Smith, J.	6	52	$ 300 00	$ 50 00	$ 250 00	$ 50 00	$ 200 00	$

Form 16. Tabular Ledger for Subdivision Accounts

R's. This method leads to confusion, for the sale is referred to sometimes under one name and sometimes under the other; or the tickler and other records may fail to show the transfer. The best method is to close John Doe's account by the entry (preferably in red ink) "Balance transferred from John Doe to Richard Roe." In this way it is always easy to trace the history of any lot, even if the tickler is deficient.

The accountant should allow no month to pass without taking off a trial balance from each and every sub-ledger, even if it is only an adding machine list; and in all cases these lists should be filed with the month's papers for future reference.

CHAPTER VI

PROPERTY RECORDS

§ 24. Report of Real Estate Transactions

To record the technical details of real estate transactions in a proper manner, the bookkeeper must be furnished with complete data, and this can best be accomplished by the use of special forms. Form 17 will suggest the lines to be followed, the salesman's report shown giving the facts of each sale. A slight modification of the sales form will adapt it for a report of purchases. After these facts are recorded by the bookkeeper, the reports should be permanently filed for reference in case any question arises in the future as to the details of a transaction.

The use of some such adequate form of report cannot be emphasized too strongly, for otherwise the records will often show blank spaces where information should be found. In other words, it is impossible to maintain a complete set of real estate records without a sure and uniform foundation as to purchases and sales, such as is afforded by this form of report.

The certificate of title shown in Form 18 is the result of a good many years' experience and may be taken as a general indication of what is desired, the chief object being to set forth clearly and briefly the main facts, instead of leaving them to be "dug out" of an opinion of title occupying perhaps many pages of typewriting.

§ 25. Property Index

The purpose of this index is to enable the bookkeeper to turn to the records of any piece of property though only

---

THE ALPHA LAND COMPANY
JACKSONVILLE, FLA.

REPORT OF PROPOSED SALE

No..............

.......................191..

I have this day arranged to sell to..............................
.... of ....
the following described property owned by.......................
Lot ....
Block ....
Subdivision ....
on which there is situated.......................................
The total purchase price is............................ $..........
Payable as follows: Cash.................. $..........
Contract, payable $.........monthly........ $..........
First payment due.........................
Mortgage, payable......................... $..........
He is also to assume mortgage, viz:
.... $..........

Making the total price of $..........
Interest is to be payable..............at the rate of..........per cent.
Commission of $............payable to..............................
IMPROVEMENTS:
The company agrees to erect for the purchaser a....................
which is estimated to cost $.............., which is to be added to the above figures and is to be covered by the above payments.

..............................Salesman

Papers drawn:

Entered, Property No.	Mtge. Payable No.
Contract No.	Book tickler
Mtge. Receiv. No.	Plat

Approved....................................

Form 17. Report of Sale

Opinion No........... Application No........... Loan No...........

United States Trust & Savings Bank,
Jacksonville, Fla.

....,.....................191..

Gentlemen:—

I hereby certify that I have examined the title to the following described property, lying .... County, viz.:

....

as set forth in the following abstracts, viz.:

No.......... made by..................... Dated..................

(Leave blanks here for further abstracts.)

Based upon these abstracts, my opinion as to the title to said property is as follows:

1. The Fee Simple title was on the ...... day of ....191.. vested in...
   Subject to the following encumbrancees:
2. Mortgages ....
   ....
   See entries Nos............... Abstracts Nos..................
3. Taxes, State and County....................................
4. Taxes, Municipal...
5. Other liens and judgments..................................
   See entries Nos................. Abstracts Nos.................
6. If the encumbrances noted above be cleared from the title by the following action...
7. In my opinion a promissory note, secured by a mortgage executed by .... would, when duly recorded, constitute a first lien on said property.

....

Attorney-at-Law

Remarks:

....

Form 18. Certificate of Title

the name of the vendor is known, and furnish a list of all real estate acquired. It is convenient to number each piece of property consecutively as it is acquired, and to give it some descriptive title, as the "Jones Property," the "Carsley Hill Property," or the name of a subdivision of a larger property, as "Lake Side." In any case, the name or names

NO.	DESCRIPTION	A	B	C	D	E	F	G	H	I	J	K	L	M	N
1	L. 2, Smith addn			Caldwell, B. J.											
2	Bl. 20, Hope addn.								Hope, Jas.						
3	Lot 224, Jenkins Map						Fredericks, O.								

Form 19. Property Index

selected are entered on the property index in the column headed with the initial letter of that name, as indicated in Form 19. Each piece of property should be entered immediately on receipt of the deed. Such an index enables any employee, whether familiar with the books of account or not, to refer promptly to any particular property.

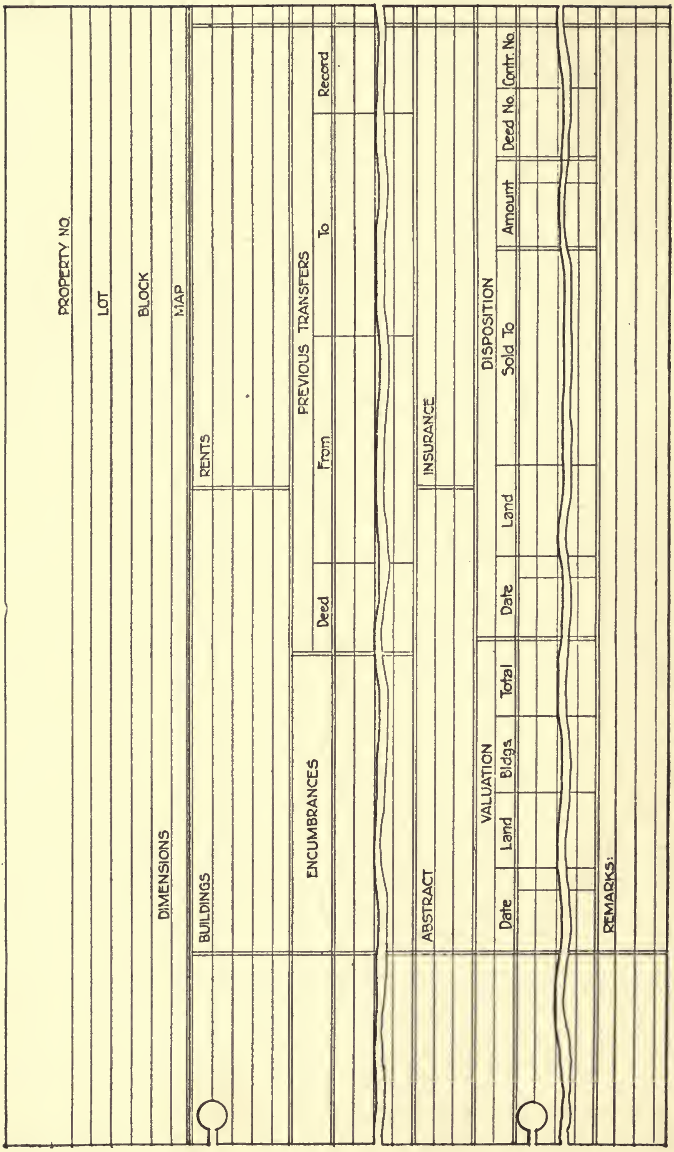
§ 26. Property Ledger—Wild Lands

The property ledger is the most technical and distinctive of the entire series of real estate records, and one of

Column	Purpose of Column			Width Inches
1	For description (By metes and bounds or by forties)			6 7/8
2	Section			7/16
3	Township			7/16
4	Range			7/16
5	Whence Derived	Deed No.		1/2
6		Date of Deed		3/4
7		Grantor		1 1/2
8		Recorded	Book	1/2
9			Page	1/2
10	Abstract No.			11/16
11	Previous Transfers	Instrument		3/4
12		From		1 1/2
13		To		1 1/2
14		Recorded	Book	1/2
15			Page	1/2
16	Value	Valuers		1
17		Date		3/4
18		Amount		1
19	Cost			1
20	Encumbrances	Nature		1
21		Mortgage No.		1/2
22		Amount		1
23	State and County Taxes	Year		1/2
24		Valuation		1
25		Amount of Taxes		1
26		Date Paid		3/4
27		Receipt No.		5/8
28	Charges	Date		3/4
29		Purpose		1 5/8
30		Amount		1
31	Disposition	Date		3/4
32		To		1 1/2
33		Sales Record		3/4
34	Remarks			6

Form 20. Property Record or Tract Book (table showing the nature and width of columns)

the most important. It records all the details of every piece of property in which the concern is interested. In other lines of business there is no record with which the property ledger may compare, unless perhaps a perpetual inventory; but real estate is a less liquid asset than merchandise, and the items of a property ledger have a value



Form 21. (a) Property Ledger (face)

Year	STATE AND COUNTY TAXES				CITY TAXES				EXPENSES			
	Assessed Value	Amount of Tax	Date Paid	Receipt No.	Assessed Value	Amount of Tax	Date Paid	Receipt No.	Date	For	Amount	

Form 21. (b) Property Ledger (back)

far more permanent than the items of a mercantile inventory. Particulars regarding merchandise can usually be gathered from filed invoices, whereas the corresponding information regarding real estate is more varied and technical, and is more difficult to obtain as it must be drawn from a variety of records. The property ledger will be found equally useful in other lines of business when large tracts of land are held.

Owing to the many purposes which a property ledger serves, it is difficult to devise a single form which will in all cases yield the best results. Several forms are therefore given, which, besides meeting the requirements of the special cases for which they were designed, will suggest forms suitable under other conditions. The problem is to provide a record which is convenient for reference and which exhibits clearly all the essential facts.

Forms 20 and 21 illustrate respectively the bound volume and the loose-leaf book. Experience has demonstrated the great superiority of the loose-leaf form. It is more convenient in size, and provides for indefinite expansion by the insertion of additional leaves wherever they may be required. On account of this elasticity it has nearly displaced the bound book.

Form 20, the bound volume, can be used to best advantage in cases where no new land is to be acquired, i.e., where the concern can at once make up complete and final lists. The following remarks apply equally to Forms 20 and 21.

The first step in writing up a property ledger is to select the unit, and as there is no uniform method of surveying which has been adopted throughout the entire United States, it is impossible to give forms applicable everywhere. The examples which follow are based on a United States township as being the most generally used.

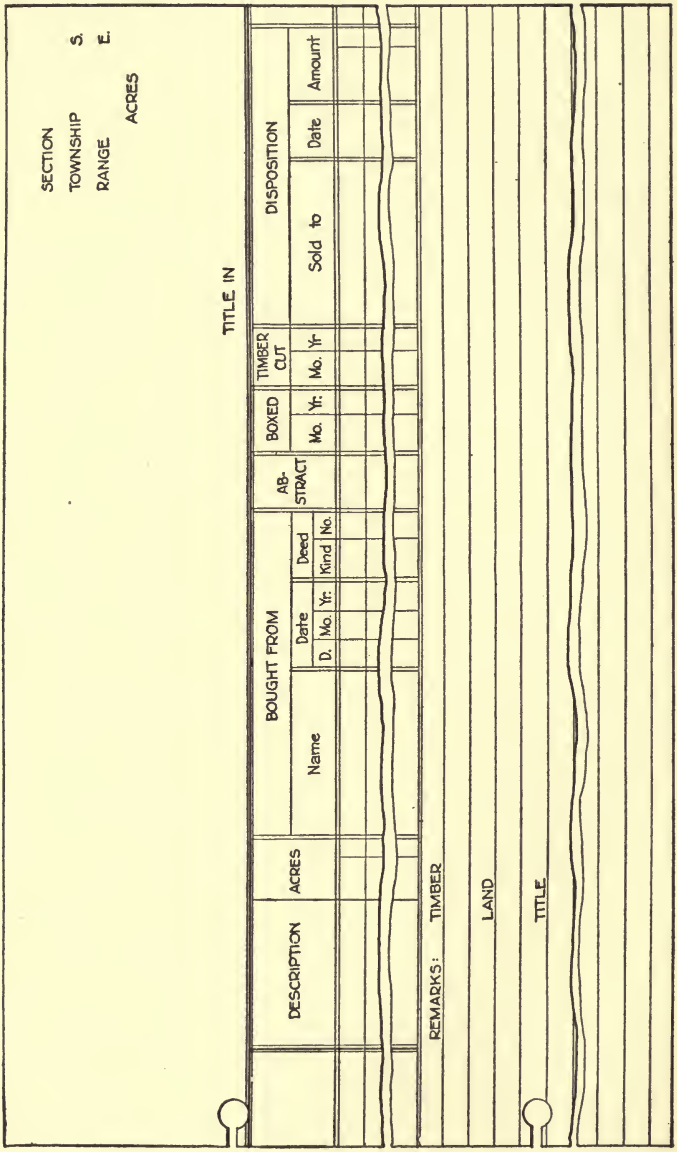
In making the entries, the data should always be taken direct from original deeds and not from transcripts or memoranda. Every time a description is copied the probability of error is multiplied, and for this reason the record should always be made directly from deed to ledger.

For convenience in making up tax lists and tax returns, it is best first to arrange the lands by counties, as it is usually the county which assesses and collects the taxes. Having done this, let it be assumed that the unit within the county is the township. This unit is six miles square, and is ordinarily divided into 36 sections, numbered from 1 to 36, although it frequently happens that, owing to old grants or other similar causes, townships are irregular. In such instances the irregular sections are usually indicated by numbers from 37 upwards. As a rule, all the lands owned in any one section should be entered on the same sheet of the property ledger, although in some cases a finer subdivision may be made with advantage, as for instance, where different lands in the same section are derived from different sources.

The sheets of the property ledger should then be arranged in regular order, either of township or of range, some offices preferring one order and some the other. By the order of township is meant the following arrangement:

Section	1	Township	1	Range	1
"	2	"	1	"	1
"	1	"	1	"	2
"	2	"	1	"	2
"	1	"	2	"	1
"	2	"	2	"	2

The regular section consists of 640 acres, divided into quarter sections and described as N.E. ¼, etc., each of which is again subdivided into 40-acre tracts, described as N.E. ¼ of N.E. ¼, etc. When a whole section, or



SECTION
TOWNSHIP S.
RANGE E.
ACRES

TITLE IN

DESCRIPTION	ACRES	BOUGHT FROM						ABSTRACT	BOXED		TIMBER CUT		DISPOSITION		
		Name	Date			Deed							Sold to	Date	Amount
			D.	Mo.	Yr.	Kind	No.		Mo.	Yr.	Mo.	Yr.			

REMARKS: TIMBER

LAND

TITLE

Form 22. (a) Timber Land Record (face)

MEMORANDUM RE STATE AND COUNTY TAXES

ACRES

SECTION

TOWNSHIP S.

RANGE E. AS DESCRIBED ON THE REVERSE HEREOF

DESCRIBED BY THE TAX ASSESSOR AS

YEAR	VALUATION	AMOUNT	RECEIPT NO.	REMARKS
1895				
1896				
1897				
1898				
1899				
1900				
1912				
1913				
1914				
1915				
1916				
1917				
1918				
1929				
1930				
1931				

Form 22. (b) Timber Land Record (back)

Warranty Deed	From Charlotte H. Holland and husband	To Annie Eliza Skinner	Deed No. 5
Consideration: $1,000.00 Dated: February 8, 1917 Conveys: Part of the Richard or Mill grant Beginning at a cedar stump on the left and S. bank of "Big Pottsburg Creek" from which stump a cypress tree 30 in. in diameter and marked with an "X" bears S. 25 deg. E distant 19 links, etc. (balance of description omitted).		Recorded: Book "122" page 99 Re-recorded: "3" " 236 Sec. 52, T. 2 S. R. 27 E. 31.77 acres	
Warranty Deed	From Daniel E. Thomas	To Annie E. Skinner	Deed No. 6
Consideration: $100.00 Dated: November 6, 1917 Conveys: The most easterly 8 acres of that certain 15-acre tract conveyed by Uriah Bowden and wife to Cornelia Taylor, September 27, 1899. Recorded in Book "A L," pp. 733-4-5-6, being part of the F. Richard grant having been conveyed to the grantor by O. B. Taylor, April 11, 1915.		Recorded: Book "6," page 322 T. 2, S. R. 27 E. 8 acres	

Form 23. Record of Deeds Received

any portion consisting of more than 40 acres, is written on the property ledger sheet, the tract should be broken up into these forties, and the exact acreage be shown. It will be seen in the timber land record shown in Form 22 that 16 lines are provided, one for each "forty" in a section, so that if this plan is followed, the disposition of any forty may be shown without disturbing or rewriting the descriptions for the rest of the section. It will frequently occur that descriptions of small tracts in irregular sections are so complex that it is advisable to enter each one on a separate sheet as in Form 23.

It is sometimes required to form a bound-book record from a mass of deeds covering contiguous lands. In such cases it is convenient to use the listing slip shown in Form 24 for the description of the property. These slips measure 5½ × 11 inches, and when printed can be put up in pads. They are written up, one for each deeded piece of land, arranged in order, and copied into the book, the entries being checked against the original deeds.

The property record outlined in Form 20 is one used in an office which controls large tracts of land of varied character and widely distributed. It is a bound book and its data was compiled by the use of the land list shown in Form 23, and, as no further lands were acquired, the bound-book form has not been found inconvenient, though the entries relating to taxes have overflowed the space allotted to them.

The sheets used in this record are 21 inches wide and 17½ inches deep, making a book 42 inches wide when open, the record running entirely across the folios. The books from which these dimensions are taken form a series in which were recorded lands in some thirty different counties.

Each page is headed with the name of the county in which the land lies. The horizontal ruling is in faint blue with five lines to the inch, every ninth line being ruled in

DESCRIPTION				PROPERTY NO.	STREET	WHENCE DERIVED			RECORDED		ENCUMBRANCES		COST
Subdivision	Lot	Bl.	Map			Deed	From	Date	Book	Page	Mtge. No.	Amount	

Form 24. Listing Slip

heavy purple; no more than one section of land is entered in the space between the purple lines.

Columns 5 to 9 are frequently of great use in showing the source from which the particular land came — a fact it is often convenient to have at hand. Columns 11 to 14 are required in cases where it is convenient to show those through whom title has passed. This information is especially useful in some states where land is held under tax titles of more or less uncertain value. If these columns are omitted, a double set of "Taxes" columns may be inserted.

The property ledger shown in Form 21 was devised for a land company owning wild lands and city property, and is practicable for both classes. The size of the sheet is shown as 9¼ × 11¼ inches, although many prefer 11 × 12 inches. The blank heading is of sufficient size to allow an ordinary description to be given at length. The back of the sheet provides for a record of taxes paid and expenses incurred.

The timber land record shown in Form 22 was arranged for an estate consisting of pine lands, the title of which rested in sundry individuals. It provides for the following special points:

1. Plats of the lands described, this information being permitted by the large headings.
2. Particulars as to turpentine and logging, etc.
3. The record of the tax assessor's description in the tax statement on the reverse side of the sheet.

As a considerable part of these lands lay in large grants, the descriptions being by metes and bounds, the tax assessor's description was merely the book and page on which was recorded the deed conveying the particular piece to be taxed. Until this information was entered on the prop-

erty record, there was constant difficulty in assigning to the particular property any item of taxes paid.

This form was used in connection with the land list shown in Form 23, and as the lands were being continually used for grazing, logging, and turpentine, it proved very satisfactory.

Whatever form of property record is adopted, great care must be taken to insure the entry of all particulars of a general nature, such as quality of soil, timber, minerals, etc.; also all options, leases, or privileges of any kind which may have been granted, as well as the receipt of any consideration therefor, either on the Principal account or on the memorandum income account.

As will be noted, apart from its other uses the property ledger forms a perpetual inventory of what is practically the "merchandise" of a real estate concern. One of the features of real estate accounting is the comparative ease with which an absolutely correct record of everything "on hand" can be maintained.

All the property records shown here provide for the entry of details regarding taxes as well as of land descriptions. Thus the value of such a record increases with its age. The forms must necessarily be modified to meet local conditions. (See Chapter XXXV.) It is important to have such a complete record, but this fact is frequently overlooked.

§ 27. Property Ledger, City Properties

It is beyond question that the most convenient form for the record of city properties is a loose-leaf book. As already stated, the property ledger shown in Form 21 is suitable for this purpose, as is also the city property ledger shown in Form 25. The latter form provides for the entry of all essential information and is almost self-explanatory.

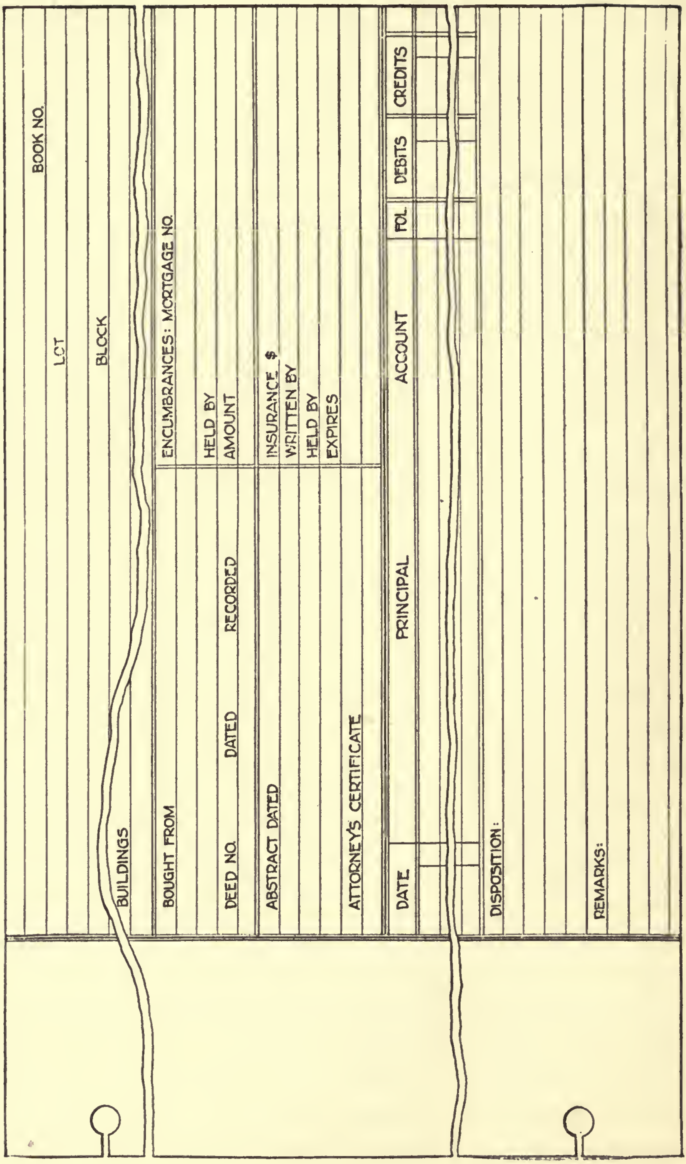
Particulars as to appraisals and selling price may be entered in the "Remarks" division, while expense and receipts may be put on the back as memoranda.

The most convenient method of arranging this ledger is to keep together all sheets relating to the same subdivision, arranging them in alphabetical or geographical order as may be desired, and separating them by blank sheets of heavy paper, to each of which is attached a movable index tag giving the name of the plat referred to on the sheets following. This method gives immediate access to the records of any piece of property of which the description is known. If the name of the vendor is known, reference to the property index (Form 19) will give the subdivision; while, if only the street address is known, the property can be located by means of the rent record given in Form 32 (§ 37).

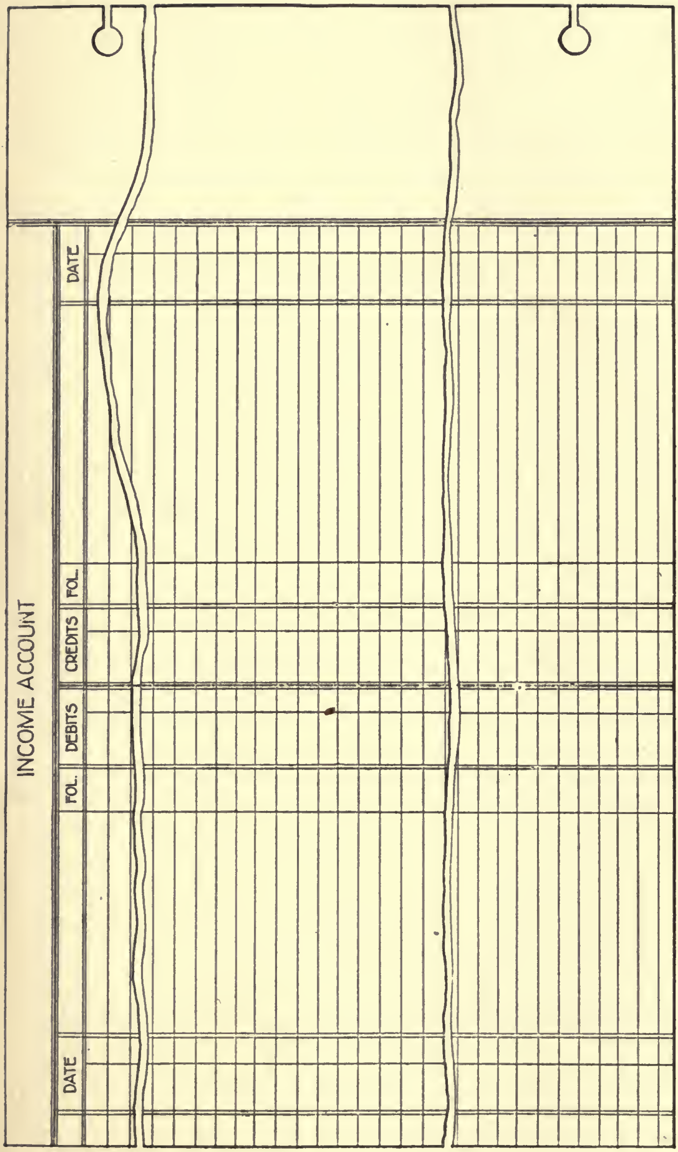
Such an arrangement assists an auditor materially, as it insures against the duplicate entry of any piece of property and provides for the entry of all mortgages on any property in one place—matters which could not be determined under any other arrangement without much search.

To illustrate, let us suppose that a piece of property is described in several ways, such as "part of lot," or "north ½ of lot," or by metes and bounds. Quitclaim deeds to the property may be obtained, in each of which a different form of description is used. If the property ledger is arranged in the order of the dates of deeds, or in alphabetical order by the names of grantees, separate mortgages might be entered under the several descriptions, and one or more might escape even a careful checking.

When writing up the property ledger sheet for any improved property, care should be taken to enter separately the value of the land and the value of the improvements,



Form 25. (a) City Property Ledger (face)



Form 25. (b) City Property Ledger (back)

EXPENDITURE AND MAINTENANCE						
DATE		JRNL FOL.	FORECLOSURE EXPENSE	REPAIRS AND IMPROVEMENTS	INSURANCE	TAXES

Dr.				Cr.

Dr.	RENT	ACCOUNT		Cr.

Form 26. Property Ledger—English Form

even if this division of the cost must be approximated. This information is necessary for insurance purposes, and also in connection with tax matters, and to determine whether or not depreciation should be charged — something considered more fully under "Depreciation" (Chapter XXXII).

It not infrequently occurs that land bought and entered as wild land, or as a city block, is subsequently subdivided and replatted into small parcels. If the subdivision contains a large number of lots, it is not necessary to enter each separately on the property ledger, as they can better be recorded on the plat books and ticklers discussed in §§ 29, 30.

If comparatively few lots result from such subdivision or replatting, it may be advisable to carry each lot in the property ledger on its own account. In such case, the original account in the property ledger is closed by a journal entry and new accounts are opened, one for each lot of the subdivision, care being taken to divide properly the cost among the new subdivided lots.

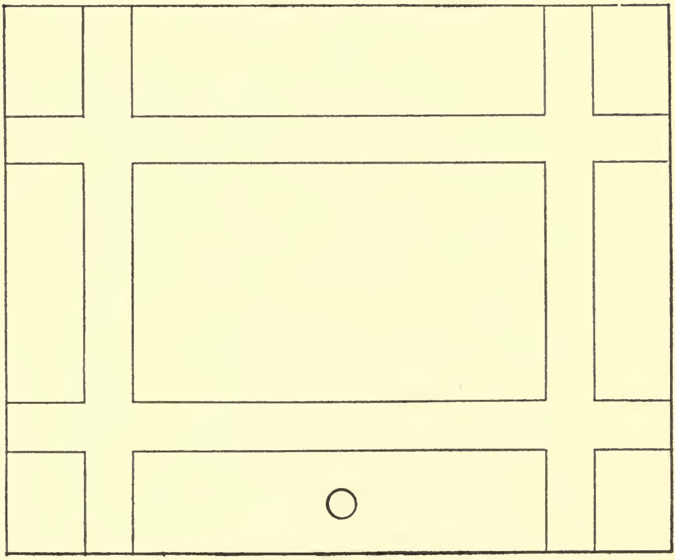
The property ledger shown in Form 26, given as an alternative method of recording property, is entirely different from the property ledgers already shown. It was designed for English practice — a fact which accounts for the small space reserved for rents, which in that country are generally paid quarterly.

§ 28. Field Record

It is often advisable to have a record of wild lands or of city lots, which may be carried in the pocket. In such cases, the most convenient form is a small loose-leaf book, 5 × 7¾ inches, in which each page is devoted to one piece of property and shows the important particulars. For lands divided into United States townships, pocket plats may be used, on each page of which a skeleton township is ruled.

R E. No.	No.	Price $
Bet.		
Height	Material	
Lot	Size	
Heated by	Rooms	
Lease	Plumbing	
Survey	Assd. Val.	Mtge.
Price	Ins.	Due
Improvements		
Remarks	1st $	1st $
	2nd $	2nd $
	3rd $	3rd $
	4th $	4th $
	5th $	5th $
		Total-Rental $

Form 27. Card Property Record (face)



Form 28. Card Property Record (back)

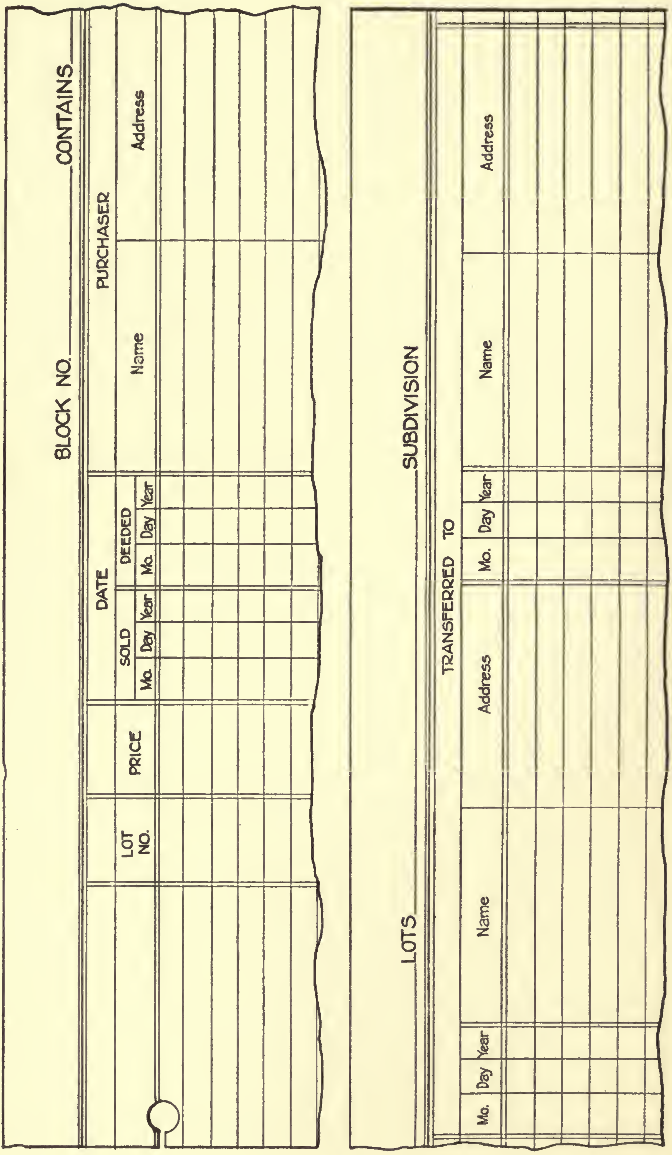
Still another alternative is to keep a card index, subdivided so that it is possible to remove quickly all the cards relating to a certain district, and carry them when making an examination on the grounds. A card record of this style is shown in Forms 27 and 28, the particulars being practically the same as would appear in the small loose-leaf book mentioned above.

Such records are almost essential, as much information can best be secured on the grounds and, with this pocket record, may be immediately entered in its appropriate place. The record then forms also a tickler, which may be carried in the pocket during inspection trips or when showing properties to prospective buyers.

§ 29. Subdivision Ticklers

In the case of what is known as subdivision property, it is well to have a separate tickler for each subdivision. The usual method of keeping this is either on cards or in loose-leaf books, each tickler being accompanied by a plat or map of the subdivision in question. This plat should show clearly all lots in the subdivision owned by the company, those covered by option or by contract, and those which have been conveyed to purchasers or others. To distinguish these various classes of lots, check marks of different colors may be used. Such plats are not only of daily use to the office force, but display clearly the facts which an auditor must have when verifying the amount of property on hand as against the amount of money charged to such property in the real estate ledger.

A loose-leaf form of tickler is shown in Form 29, one leaf or more being devoted to a block (or corresponding division), and two or three lines being allowed for each lot in that block. On these lines appear the names of the purchasers, which in the case of time sales are best written



Form 29. Subdivision Tickler

in pencil, as transfers or assignments are of frequent occurrence.

§ 30. Plat Book

This book is composed of plats of the lands described in the property ledger. In those states in which the United States township is used, these plats can be most easily shown on the official government plats of each township, which may be obtained from the United States land offices and should be mounted on canvas before being bound. By the use of varied tints, different interests and different conditions may be more conspicuously shown on these plats than in a written record, although the property ledger must furnish the necessary information.

§ 31. Record of Deeds Received

The object of this record is to facilitate reference to any desired deed. There are two forms in which this record may be kept, one of which is a numerical index in which there are columns for the following details: number of deed; name of grantor; kind of deed, that is, warranty deed, quitclaim deed, etc.; date of deed; place of recording deed; county; space for various entries.

Form 23 (§ 26) may be used as an alternative. Although this form requires more writing than that described above, it saves constant reference to the actual deeds, which should be kept in the vault. The form chosen must depend on the preference of the person keeping the record and on the requirements of his office. In a general way it may be said that the form first mentioned is better adapted to the needs of a general land company which buys and sells lands, while Form 23 better serves the needs of those who hold lands, not primarily for sale, but for investment, grazing, logging, or other similar purposes.

§ 32. Record of Deeds Issued

Special attention is called to the record of deeds issued (Form 30), the object of which is to keep a permanent record of *every* deed executed by the concern. This matter is often overlooked in real estate offices, but a little thought

---

........................Deed No...........
Date..................... From..............................
To ....
Consideration $................. Actual......................
....
Terms ....
Payable ....
Property: Tract Book No................ Serial No...............
.... County ....
....
....
....
....
....
Contract No................... Mortgage No..................
Other Papers delivered..................................
....
....
Executed by..
Delivered to...
Total Acres......................Value on lists $................
C. B...............................Gain $................
Journal..............................Loss $................
Verified by..

Form 30. Record of Deeds Issued

will show its importance. No wholesale merchant will deliver goods without keeping some record of the transaction; yet many real estate offices, even though doing a large business, fail to keep any distinct record of deeds and other similar papers executed and delivered.

If all deeds given by a concern are to be of one form, it is best to have them printed, numbered consecutively, and bound in book form on stubs. Each stub should provide appropriate spaces for the following information:

Date of deed; name of grantee; consideration (both the actual and the nominal, if they differ); terms of sale and method of payment; description of property, with serial number; number of contract or mortgage in connection with which deed is issued; names of parties executing the deed; name of person to whom deed is delivered; any other papers delivered, such as releases, quitclaim deeds, etc.

In using this form, the blanks are filled in with pen and ink. Care should be taken to compare the stub with the deed, when both are completed, and to have the stub initialed by the person responsible for the verification. In the case of subdivision properties of large size, it is convenient to have a separate deed book for each subdivision, with the name or description of such subdivision printed thereon.

Another system of keeping office records of deeds issued is to have the deed form occupy but a single page, and to make a carbon copy of each deed as it is issued. These copies are then arranged numerically and filed in a binder. This system gives good results, the only serious objection being that when a copy of a certain deed is called for, there is a strong temptation to remove it from the binder, with the probability that it may not be returned to its proper place.

If various forms of deeds are used, the record may be

kept in a book specially prepared for that purpose. In addition to the particulars already mentioned, this book should show the kind of deed given, i.e., warranty, special warranty, quitclaim, etc. The record shown in Form 30 has been used for this purpose for many years by a company whose head office is far distant from the local office in which the business is transacted. The head office keeps a complete duplicate set of records, copied originally from the local books and kept up to date from the record of deeds issued.

Whatever method may be adopted, the rule should be rigidly observed that no deed be allowed to leave the office until a permanent written record of it is made. At the time, this may appear of little consequence, but in all records connected with real estate there is a strong possibility that at some future time it may be necessary to refer to the original transaction, and permanent records are therefore even more necessary in this line of business than they are in a mercantile or manufacturing enterprise.

§ 33. Record of Contracts Issued

The general remarks as to the importance of office records of deeds issued apply also to the record of contracts; but the method of keeping this record is somewhat simpler, owing to the fact that the important particulars of each contract are shown by the entries in the contracts sub-ledger.

It is a general practice, from which there should be no deviation, to execute every contract in duplicate, the vendor and the purchaser each receiving a copy. If this is done and the copies filed, numerically or alphabetically, in the order followed in the contracts ledger, and if the contract is entered on the property ledger, no further record is required.

§ 34. Record of Options Granted

This record is similar in all respects to that for contracts, and it is to be noted that three distinct records are required:

1. A copy of the paper executed.
2. Particulars in the sub-ledger.
3. Particulars in the property ledger.

§ 35. Subdivision Histories

This form is required only in those offices where many different subdivisions are handled. It consists of a memorandum book or collection of loose leaves, one or more pages being devoted to each subdivision and the necessary particulars entered thereon, as indicated in Form 31.

Originally carried as Property No. 275
2811 NOCATEE FARMS
Transfer to Nocatee Purchase 1916 Owned by the Concern

Commenced in 1914 report. Bought from Union Bank. Tracts 5 acres each.

(No. 275) 3,890 acres bought from Union Bank for $11,670. Payable
October 1, 1914, $2,000
Quarterly payments $1,000 each, with interest at 8% per annum.

(No. 2811) 160 acres bought from J. Summer for $958.75.
Up to April 30, 1917, all profits based on cost of $3.00 per acre.
There are 3,890
160 4,050 acres

Cost Bank	$11,670.00		
" Summer	958.75		
Interest to Bank	953.10		
" estimated on unpaid balance.	200.00	$13,781.85,	
		or, say $4.00 per acre.	

April 30, 1917 245 tracts unsold at $20.00... $4,900.00
Purchase Account..... $4,438.75

Form 31. Subdivision History

CHAPTER VII

RENT RECORDS

§ 36. Record of Leases Given

In those few offices in which it is possible to issue a considerable number of leases of the same general character, either of the methods outlined in § 32 for the recording of deeds may be followed.

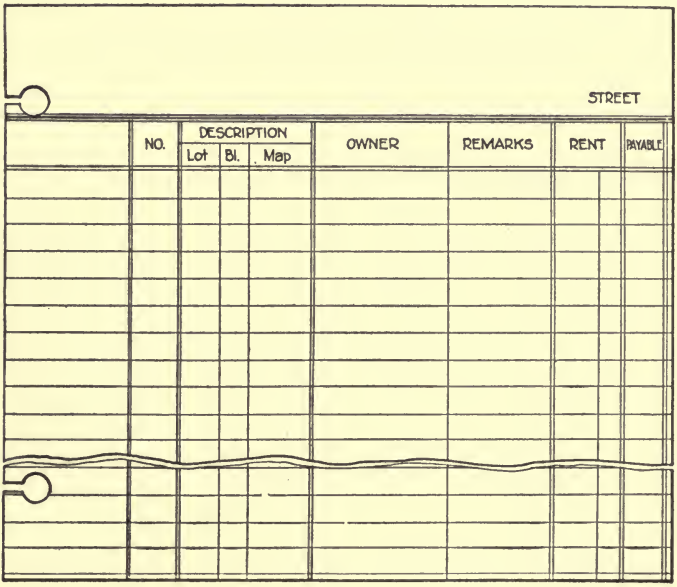
In most cases, however, the forms and terms of leases vary so greatly that such a record cannot profitably be kept, and it is sufficient to number consecutively all leases given, as indicated in § 342, the original papers being filed accordingly and a simple index of all leases maintained.

In any event, whatever the nature of the property leased, it thereupon becomes rent-producing, and the lease should accordingly be entered by its serial number on the property ledger, the rent register, and the rent ledger, together with such details of the terms as may be desired. If the rent is payable at frequent intervals, as once a month, no further record is required; but if the payments fall due at longer intervals, as quarterly, semiannually, or annually, there is danger that they may be overlooked unless some tickler record is made. In such cases the rent payments may be indicated on the rent record shown in Form 32, or they may be entered on the same form as the interest receivable, but in such manner as to indicate to the bookkeeper that the entries refer to rents and not to interest.

§ 37. Rent Register (House Address Book)

This book is invaluable for any office interested in a large number of houses for rent or sale. It is intended to

contain a record of all rentable properties owned by the company, or in which it has an interest through contract, mortgage, or as renting agent. It may be bound or in loose-leaf form. In either case, it should be indexed alphabetically and each page be headed with the name of a street or neighborhood in which the concern has rental property, the object being to provide a means for finding quickly



Form 32. Rent Record

all the houses on any one street and to indicate the nature of the interest involved. As it contains a complete list of *all* rentable properties in which the concern is interested, it forms the basis for the work of the rent department.

The loose-leaf rent record or register shown in Form 32 has been in use for many years and is self-explanatory. If houses are sold on time, this fact is shown in the "Remarks" column, and when the sale is completed, reference

is made to the serial number of the mortgage, contract, or option, and a red ink line is ruled through the entry.

If the number of rentable houses is large, it may be advantageous to prepare a rent register board similar to that used for recording the occupancy of rooms in a hotel. This board should be large enough to hold a card for each house on the rent register, and so constructed that a smaller card may be inserted in front of, and covering up the lower part of, the larger one.

Each of the larger cards (which may be 1×3 inches) bears along its upper edge the address of a house and the nominal rent thereof. These cards are arranged on the board in order of streets, of rental values, or of owners, as may be most convenient. Upon a house being rented, the date, name of tenant, and particulars as to the rent are entered on one of the smaller cards (which may be $\frac{1}{2} \times 3$ inches and of a different color from the larger cards), and this card is then placed on the board in front of the larger card in such a way as to leave exposed the address of the house. A board so arranged shows at a glance every house offered for rent, all houses that are vacant, and all houses that are rented, together with the name of the tenant and other particulars.

§ 38. Rent Receipt Books

The same principles that obtain with reference to the general receipt book (§ 12) apply with equal force to rent receipt books, the main difference being that the latter are properly of such size that collectors can easily handle them. (See Form 33.)

Not infrequently an unscrupulous tenant will claim to have made more payments than appear on the cash book, and may produce in support of his claim a receipt which has been changed as to amount, date, or name. The best

THE ALPHA LAND COMPANY
NOCATEE, GEORGIA

$........... ....191..

Received of..

.... Dollars,

being rent of No...Street,

for .... to .... 191..,

....

Collector

(This receipt made in duplicate)

Form 33. Rent Receipt

evidence against such a claim is the carbon copy of the receipt, which cannot be rebutted.

§ 39. Report of Rent Collections

The rent report shown in Form 34 was designed by English accountants for use in this country in connection with property owned in England, a copy being transmitted to the home office. In such cases, or wherever the chief office is located at a distance from the property, this form is valuable for tabulating the large number of details to be reported. Its practical value here, however, is impaired by the difficulties which attend the collection of arrears of rent, owing to "exemption" laws and the general leniency toward delinquent tenants which is found in so many states.

All offices employing rent collectors should require from them regular and uniform reports of their daily collections. For this purpose the report shown in Form 35 has been found convenient. It may be printed on inexpensive paper, bound in pads of fifty each, and perforated for filing in a "Shannon" file. (See also Form 49, § 307.)

MONTH OF ____

No.	NAME	NO. OF HOUSE	ADDRESS	LED. FOL.	RENT	ARREARS BROUGT FORWARD	DATE		LED. FOL.	RECEIVED		ALLOWANCES	AMOUNTS WRITTEN OFF, IRRECOVERABLE	ARREARS CARRIED FORWARD
							Due	Paid		Amounts Current	Amounts Outstanding			

Form 34. Rent Report

REPORT OF RENTS COLLECTED

_______________191__

BOOK NO.	STREET NO.	STREET	TENANT	OWNER		

Form 35. *Rent Collector's Report*

§ 40. Rent Cash Book

For an office handling many rental houses, it is usually convenient to keep all matters pertaining to rents out of the general cash book. An ordinary cash book may be used for this purpose. All rents received, taken direct from the rent collectors' reports, are entered on the debit side, while on the other side are entered all payments made on account of such houses for repairs, insurance, etc.

Where such a book is kept, it is well to deposit all receipts from rent as shown therein, in a separate bank account, and to charge against this account all moneys paid out for repairs, etc., using for this purpose a check differing from that used in connection with the general cash account. At the end of each month the balance of this account is transferred to the general fund. This method

eliminates from the general cash book a vast amount of detail which is shown to better advantage by itself.

§ 41. Rent Journal

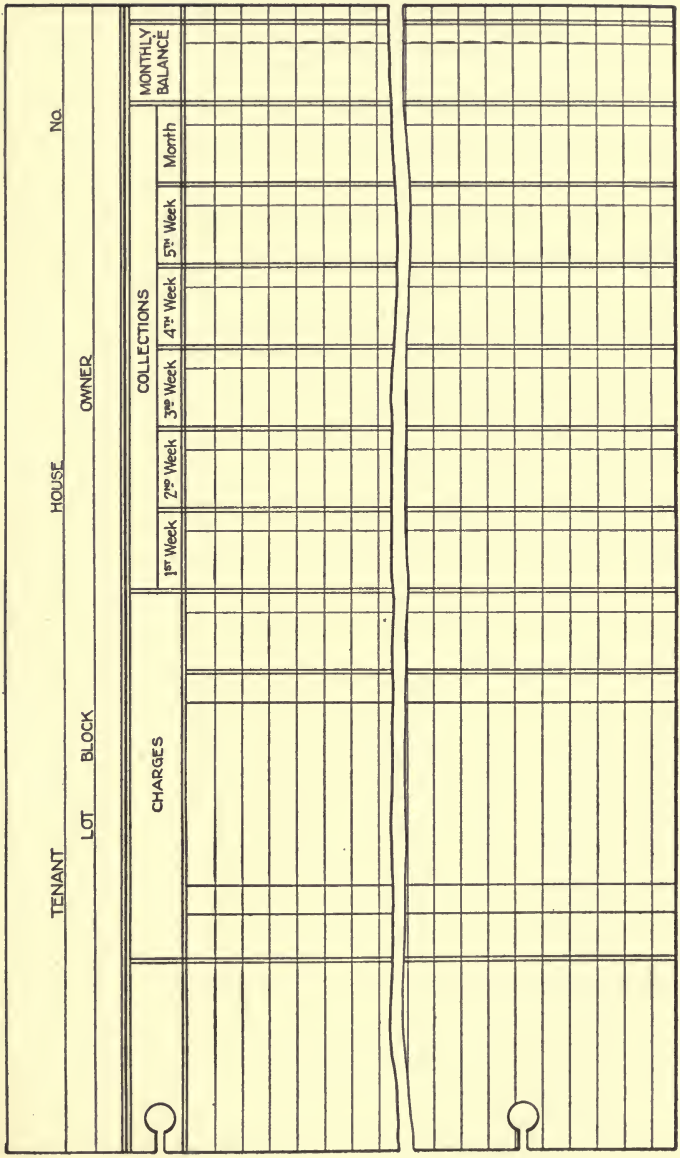
The journal entries required in connection with a rent department are few and simple, an ordinary journal with three or four columns meeting every requirement. Such entries relate almost entirely to the issue of material from the "yard," if such is maintained, and to brokerage charged against clients, as outlined under "Rent Ledger" in § 329.

§ 42. Rent Ledger

This sub-ledger shows the gross and net rent received from each building on the rent roll, and is used when the items in these accounts are too numerous for the space provided in the property ledger. The subject is considered more fully in §§ 329, 330.

No special form of ruling is required for the rent ledger, but each account should be headed with the street address of the property to which the account refers, and be credited with all rents collected from that property and debited with all expenditures thereon for repairs, water rent, etc. The total of the balances of all the accounts in this sub-ledger will therefore agree with the difference between the Rents account and the Repairs account in the general ledger. If it is desired to keep in the property ledger a permanent record of the income from each piece of property, the balances from the rent ledger may be transferred periodically to the appropriate spaces in the property ledger.

Where there are many houses paying rents weekly, the rent ledger shown in Form 36 has been found serviceable. This ledger gives a continuous record of each house, and one page will hold the records of several years, thus serving to exhibit changes of tenure, amount of repairs made, the



Form 36. Rent Ledger

OFFICE NO.	TENANT	BALANCE BRT. FORWARD	RENT JANUARY	PAID IN JANUARY	BALANCE JANUARY 31	RENT FEBRUARY	PAID IN FEBRUARY	BALANCE FEBRUARY 28	RENT MARCH	PAID IN MARCH	BALANCE MARCH 31	R A
1	Robinson, J. L.	$40.00	$40.00	$80.00		$40.00		$40.00	$40.00	$60.00	$20.00	
2												
3	Bryan, James	100.00	100.00	100.00	$100.00	100.00	$200.00		100.00	100.00		
4												

Form 37. Tabular Rent Ledger

tenant for whom they were made, and regularity with which rents have been paid.

For the record of rents collected from such properties as office buildings and apartment houses, a tabular form of rent ledger, such as shown in Form 37, may be used. The simple addition of the several columns for each month gives:

1. Balance uncollected on the first of each month.
2. Total rents due from tenants each month.
3. Total rents paid by tenants each month.
4. Total rents unpaid at the end of each month.

In order to contain a year's record of monthly rents, the tabular ledger will require some forty columns. The convenience of handling such a book is greatly increased by using "short leaves," which will allow a book 29 inches wide to be used. The method of dealing with the monthly totals shown on such a ledger is explained in Chapter XXXIV, "Rents."

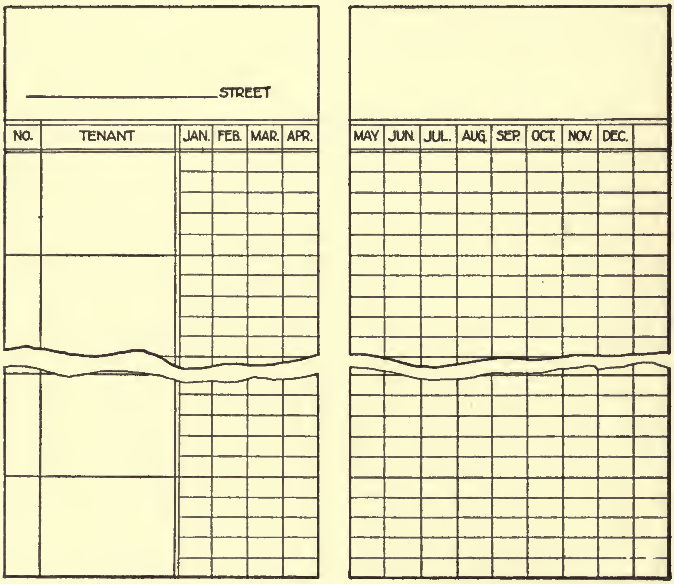
§ 43. Collector's Pocket Rent Ledger

One of the difficulties experienced by all rent collecting agencies is that of keeping the collectors informed as to the condition of each account, particularly rents in arrears.

For this purpose many offices use a card system similar to that employed by furniture dealers and others in connection with their sales on the instalment plan. One such card is maintained for each house and on it are entered the rents as they are paid. These cards are then sorted, and each day, or at frequent intervals, a certain number of them are given to the collectors, indicating to each the houses at which he is to call. As these calls are made, the collector turns back the proper cards to the office. The record is therefore necessarily divided, and is seldom, if ever, all in

one place; also it occupies considerable space and is subject to loss and disarrangement.

In order to avoid these difficulties, the "Collector's Pocket Rent Ledger" (Form 38) was devised, the use of



Form 38. Pocket Rent Ledger

which requires no explanation. If printed on thin paper, a book about 4½ × 6½ inches, and about one-half inch thick, will contain the records of one thousand houses for one year. The space between any two heavy horizontal lines is devoted to one house or building, the blue lines indicating the first, second, third, fourth, and fifth weeks of each month. Each street has one or more pages allotted to it, and by arranging the streets alphabetically at stated intervals, the book can be kept in alphabetical order throughout its life. Being primarily for the use of collectors, the book contains no other record than that of rents collected.

CHAPTER VIII

MISCELLANEOUS RECORDS

§ 44. Fire Insurance Record

This record is intended to show the expiration of all insurance policies in which the concern is interested. Any of the recognized forms of expiration register used by fire insurance agents may be adopted, or the system outlined in § 323 may be followed.

§ 45. Bills Receivable and Bills Payable

Bills receivable and bills payable books may be of any convenient form. They should contain details of all notes *not* entered in the mortgages receivable and mortgages payable ledgers (§§ 18, 19).

§ 46. Land Notes

Some companies engaged in selling lands "on time" make a practice of taking payment in serial notes. When this is done, it is better to enter such notes in a record separate from the regular bills receivable book. Probably the most convenient form for this record is a modification of the mortgages payable ledger (Form 9, § 19), space being allowed in the heading for details as to the due date and disposition of each note in the series. In preparing such a form, it should be remembered that such notes are frequently hypothecated or lodged with a bank or trust company, or placed in the hands of an agent for collection. Ample space should be provided to record such facts, so that the location of each and every note may be shown.

MORTGAGE NO.	NAME	JANUARY	FEBRUARY	MARCH	APRIL	MAY	JUNE	JULY	AUGUST	ANNUAL TOTAL
101	Smith J.	2 $20.00			2 $20.00			2 $20.00		$80.00
102	Robinson, D.		21 $100.00						21 $100.00	200.00
103	Bryant, E.			10 $10.00						20.00

Form 39. Mortgage Interest Payable Register (Small figures indicate day of month on which papers become due.)

MONTH OF ______________

NO.	NAME	LED. FOL.	AMOUNT OF COUPON	ARREARS BROUGHT FORWARD	DATE		LED. FOL.	RECEIVED		AMOUNTS WRITTEN OFF	ARREARS CARRIED FORWARD	REMARKS
					Due	Paid		Amounts Current	Amounts Outstanding			

Form 40. Mortgage Interest Receivable Report—English Form

ANALYSIS OF EXPENSE ACCOUNT FROM ________ TO ________

DATE	DESCRIPTION	SALARIES	ADVERTISING	CHARITY	STATIONERY	POSTAGE	TELEGRAMS	MISC.	CREDITS	BALANCE

Form 41. Analysis of Expense Account

§ 47. Mortgage Interest

The necessity for a record from which each mortgage may be charged with interest as it becomes payable is obvious. The only form required for this purpose is a book made of analysis paper and having at least twelve money columns, one for each month, as indicated in Form 39.*

It is sometimes necessary to make monthly reports regarding mortgage interest. For such cases Form 40, taken from English practice, gives a convenient record and is particularly adapted to branch offices which have to report to the home office or to other branch offices located at a distance. The forms required for interest payable are identical with those for interest receivable.

§ 48. Expense Account Analysis Book

It is essential to the highest economy that the expense account be frequently analyzed, and kept in such condition as to afford at all times data for a classified statement of expenses. This may be done by carrying a large number of expense accounts in the general ledger, such as salaries, stationery, etc.; but this method tends to complicate the trial balance. For some years past, many banks and other institutions with large expense accounts have made it a practice to charge all expense items to one account, and keep an expense analysis book, which provides for a more elaborate classification than can conveniently be carried in a ledger. Form 41 gives a page from such a book, which is of the loose-leaf form and well adapted to real estate offices.

*Some accountants claim that better results can be secured by dependence upon the mortgage record for all information as to interest.

CHAPTER IX

THE ACQUIREMENT OF REAL ESTATE

§ 49. Methods of Acquiring Real Estate

There are at least five legitimate methods by which the control of real estate may be acquired, viz.: (1) by gift, (2) purchase, (3) exchange, (4) recovery, (5) agency.

1. Control through gift occurs so rarely in business that it need not be seriously considered, for even when a gift is apparently made, some consideration is usually passed.

2. Purchase includes the majority of transfers, and the method of treating these in the accounts is fully considered in the present chapter.

3. Simple exchange embraces but few instances of real estate acquirement; as a rule some pecuniary consideration, or its equivalent, is involved.

4. Recovery. Unfortunately, most real estate offices occasionally find it necessary to recover property sold "on time" under some form of agreement, the terms of which have not been complied with. This involves the foreclosure of mortgages or cancellation of contracts, although it sometimes happens that a purchaser voluntarily reconveys the property gratuitously or for some consideration. In such cases the balance due on the debt, together with interest to the date of recovery, and all expenses for taxes, legal charges, etc., should be included in the cost price. If, however, this cost price exceeds the value of the property, the Mortgage Deficiency account (§ 229) should be brought into use.

5. Agency, as a rule, does not convey title, but it frequently carries with it the management and sometimes the practical control of property owned by another.

§ 50. Accounting Procedure

In the acquisition of real estate there are certain matters with which the accountant is particularly concerned. The more important of these are:

1. The report of the purchase, giving the particulars of the acquirement.

2. The documents involved, consisting usually of deeds of conveyance, quitclaim deeds, previous conveyances, satisfactions of mortgages, tax receipts, etc.

3. The certificate from the attorney as to the title, or the title policy guaranteeing the title. In large concerns this is sometimes made on a printed form. If an attorney's certificate is used, it should give not only the name of the owner, but a description in sufficient detail to identify the property positively. It should *not* read merely: "The property of John Doe" — a description so indefinite that it may be used by fraudulent persons to stretch a certificate over titles which never were submitted to the attorney for examination. (See Form 18, § 24.)

4. Any policies of fire insurance transferable with the property. These should be examined not only as to their general terms, but particularly as to indorsements which may be necessary on account of changes of ownership, or in connection with mortgages, etc.

5. The entry on the office records of the land acquired, beginning with the property index and proceeding as far as may be necessary, through the property ledger, mortgage ledger, insurance record, etc. In the entries in the property ledger, the value of land and of the improvements thereon should be shown separately, as already stated.

§ 51. Entries Required

Newly acquired real estate is brought on the books through the cash book and the journal. The cash book entries represent merely cash paid for, or on account of, any purchase. Such amounts are debited to Real Estate in the general ledger, and also to the specific account in the property ledger.

A full report of each purchase should be made, using a blank for the purpose, similar to that shown in Form 17 (§ 25). The property is then entered on the property index, and the property sub-ledger sheet is filled in and inserted in its proper place. If a portion of the purchase money is represented by a mortgage given or assumed by the purchaser, this part of the transaction will appear in the journal in substantially the following form:

Real Estate..	$5,000	
To Mortgage Payable..........................		$5,000
For mortgage No. ..... on property No.		
name		
given or assumed by the company and held		
by		

This amount is posted in the general ledger to the accounts shown, also in the property ledger, and in the mortgages payable sub-ledger.

§ 52. Mortgages Payable

Mortgages payable are of two classes, namely:

1. Mortgages given by the concern (a) to secure a part of the price paid for property, and (b) as security for money borrowed by the concern. Inasmuch as the latter may require approval by the stockholders, or others, it is sometimes well to observe this subdivision.

2. Mortgages already standing on properties, the equities in which have been acquired by the concern through purchase or exchange.

The two classes are similar, and the method of entering them on the books has already been given.

§ 53. Legal Obligations of Mortgagor

There is, however, one important distinction between these two classes of mortgages. Every mortgage imposes an obligation on the maker to fulfil the conditions named, and to make stipulated payments at definite times and places. In the case of a mortgage of Class 1, failure to live up to the obligations imposed renders the concern liable to certain penalties in addition to forfeiture of title. In Class 2, however, the concern is not the maker of the mortgage, and the extent of the obligation incurred may depend in whole or in part upon the wording of the deed conveying title to the land.

Deeds of conveyance usually contain a clause, more or less broad, warranting the title to the grantee (i.e., the purchaser), and mentioning any existing liens such as mortgages, unpaid taxes, etc., which are to be paid by the grantee. If, then, after mentioning a specific mortgage, the deed merely continues with such words as, "to which this deed is subject," or prefixes the description of the mortgage by the words, "subject to the following mortgage," but does not in terms obligate the purchaser to pay that mortgage, the exact extent of the obligation assumed by him depends on the circumstances surrounding the particular transaction. Speaking generally, in default of payment of principal or interest, the holder of the mortgage has the usual recourse against the original maker of the mortgage and against the property; but should the property fail to yield a sum sufficient to pay the debt and the expenses, the holder can-

not obtain a judgment against the purchaser for any deficiency.

If, however, the description of the mortgage is followed by such words as, "which mortgage is hereby assumed by the grantee," the conditions are changed. The purchaser then assumes the obligations of the original mortgagor; and should default and foreclosure ensue, the holder can obtain a judgment against him for any deficiency remaining after the foreclosure sale.

In large transactions, and especially if values fall, or if a title proves faulty, this apparently slight difference in the conditions may cause bankruptcy to one of the parties. Suppose, for example, a tract of land has been acquired without personal assumption of an existing mortgage by the purchaser, and some defect in title is discovered which renders further sale of the property difficult or impossible. The holder may then elect to convey the property to the mortgagee, who under such circumstances has no redress against him. If the value of the property depreciates to such an extent as to be worth less than the amount of the mortgage, it could again be transferred to the mortgagee, and the mortgage thereby be satisfied so far as the purchaser of the property was concerned.

On the other hand, if the grantee specifically assumed the mortgage, he would be forced to pay it even though the value of the property fell far below the amount of the mortgage. This is not an imaginary happening, as it has often been the cause of serious loss. In one instance alone, in the writer's experience, a loss of this nature amounted to over a quarter of a million dollars.

To the accountant the difference between these two classes of mortgages is the distinction between a contingent and a fixed liability, for in the first case the liability may cease to exist if the property is surrendered to the mort-

gagee. A discussion beyond this point would involve legal matters rather than those pertaining to accounts.

§ 54. Contracts Payable

The general principles applying to mortgages payable apply equally to contracts payable, except that frequently in the case of contracts there is no legal obligation on the part of the purchaser to complete the purchase—a failure to do so resulting only in the forfeiture of any money already paid.

§ 55. Trusts and Trustees

The acquiring of property frequently necessitates some form of trusteeship in connection with a mortgage given or bonds issued—a matter which is touched upon in § 305. Only general directions can be given to cover this case. Full details of each trust should be brought into the books of account, and such ledger accounts should be opened as may be necessary to show clearly and separately all transactions relating to the principal and interest of *each* trust.

CHAPTER X

PROPERTY COSTS

§ 56. The Elements of Cost

While the question of holding or disposing of any given piece of property is usually decided by the executive rather than by the accounting department, the decision often depends on information furnished by the latter. This information relates largely to the cost of the property—present or future. This cost may include one or more of five distinct classes of expenditure, viz.: cost of (1) acquirement, (2) holding, (3) maintenance, (4) operating, (5) investment.

1. The cost of acquirement has been discussed in the preceding chapter. It represents the actual amount spent or guaranteed in acquiring the property, and also includes the cost of physical improvements added thereto.

2. The cost of holding includes those expenses, such as interest and taxes, which are necessary to retain the property (not to maintain it), which do not increase its intrinsic value, and which are often classed under the head of "Fixed Charges."

3. The cost of maintenance applies to improved property only, and consists chiefly of such items as repairs and renewals.

4. The cost of operating applies only to a limited number of cases, such as office buildings and apartment houses, and includes lighting, elevator service, and other similar expenditures necessary to obtain the normal returns.

5. The cost of investment, as here used, does not cover the full cost of acquiring, but only the actual *cash* outlay involved. Strictly speaking, this amount is not a cost, although it is sometimes convenient to regard it in that light when calculating profits derived or to be expected.

§ 57. Treatment of Costs

It will readily be seen that the cost of acquirement differs in one notable particular from each of the other costs, in that it represents what is known in mercantile and manufacturing accounts as the "cost price" — the actual value at some definite moment; while no item of any of the other "costs" affects the intrinsic value of the property. These differences in the five classes of costs are so radical as to necessitate an entirely different treatment for each on the books of account. Provision for such treatment is made on property ledgers shown in Forms 20 and 21 (§ 26), where the main accounts show the cost of acquirement of each piece of property, the total of which must agree with the Real Estate account in the general ledger.

§ 58. Cost of Improvements

The only addition to the original cost price of property is the cost of improvements, a record of which is provided for in the property ledger main account. Such items may properly be charged directly from the cash book to Real Estate, or, as is sometimes more convenient, they may be charged to "Improvements" account, which is transferred to Real Estate account at the close of each fiscal period. The latter plan has the advantage of showing the total of such expenditures in one amount on each monthly trial balance. If it is adopted, each item should at once be posted to its proper account in the property ledger, and the total balance of these accounts will then equal the sum of the

balances of "Real Estate" and "Improvements" in the general ledger.

§ 59. Repairs, Renewals, and Improvements

From the accountant's standpoint, there are few accounts on the books which require more careful examination than the Improvements or Betterments account—a condition applying equally to all businesses in which the maintenance of any physical structure plays a part. There is frequently considerable difficulty in drawing the line between the expense item of repairs or renewals and the asset item of improvements or betterments. This difficulty is still increased by the general tendency among officials of all ranks to increase assets rather than expenses. The clerk in charge of a rental department is as desirous of keeping low his ratio of repairs to rents, as is the manager reporting to the stockholders; whereas the stockholders themselves would, sometimes at least, charge everything to assets and nothing to repairs, for by so doing these asset increments might be quickly turned into dividends and in this form reach their pockets.

If a list were made, commencing with undoubted improvements and gradually changing to undoubted repairs, nothing would be easier than to classify the items at each end of the list, while it would be extremely difficult to classify properly some of the items in the middle. The building of a new house on a vacant lot or the digging of a drainage canal through a swamp are beyond all doubt "improvements," while the replacing of a pane of window glass blown out by the wind is clearly "repairs." The difficulty in classification is not merely that of finding a definition, but of applying the definition when found. The final decision in each case must necessarily depend upon the conditions.

§ 60. Definitions

Repair is the "restoration to a sound or good state after decay, waste, injury, or partial destruction; it is the supply of loss."

Betterment is defined under American law as "an improvement of real property which adds to its value otherwise than by mere repairs."

Improvement is defined as "a betterment; that by which the value or excellence of a thing is enhanced; a beneficial or valuable change or addition. An improvement in real property is something done or added to it, which increases its value, as cultivation, or the erection of or addition to buildings."

The following definitions are taken from the rules of the Interstate Commerce Commission:

"Additions include additional structures, facilities, or equipment, not taking the place of anything previously existing."

"Betterments include the enlargement or improvement of existing structures, facilities, or equipment, or a proper proportion of the cost of new structures, facilities, or equipment of an improved or higher class, taking the place of others previously existing."

§ 61. Repairs

The definition of repairs given in the preceding section is clean-cut and definite; but even here difficulty may be experienced, particularly in connection with the time when repairs are made. In the case of the renewal of the roof of a dwelling, if that dwelling has been erected by the concern and carried for a considerable period on its books, the matter is clearly one of repairs. On the other hand, if the concern bought an old house knowing that such repairs were required immediately, the cost of the new roof would be

chargeable to Improvements, for the poor state of repair of the building was undoubtedly considered when the price of the property was agreed upon.

Consider, however, a case between these two. A dwelling supposed to be in good condition is bought at a fair market price. After a couple of years it is found that a new roof is necessary. To what shall its cost be charged? The property is already on the books at a fair and proper value. The new roof adds nothing to the *supposed* condition of the building, and the cost thereof may bring the total cost of the house fully up to, or even above, the price at which it could be sold. In such case the Repairs account would be the proper place for the entry.

The above remarks are based on the assumption that the new roof is of the same character as the old one. If the new roof is of tiling or slate and the old one was of shingles, the difference between the cost of a new shingle roof and a new tile roof is, without doubt, chargeable to Improvements account.

Professor Cole, in "Accounts, Their Construction and Interpretation,"* deals with another difficulty, encountered when a building is altered for its tenant, who, in consideration of these alterations, pays an increased rental, but leaves at the end of a year and the new tenant requires the premises restored to their original condition. If such changes were continued, and the cost charged to "Improvements," the result would be a fictitious value, ultimately expanding to infinity. This question is fully dealt with by Professor Cole, and further discussion here is unnecessary.

This brings us directly to the difficulties contained in the definitions of "improvements" and "betterments." A change in property which may result in an increase in value or excellence for one purchaser, may destroy its value or

*Chapter VII.

excellence for another. Examples could easily be multiplied, but enough has been said to show that, given full knowledge of any particular case, honesty and good judgment will direct the charges to their appropriate place. This disposal of the question, however, only emphasizes the necessity for a careful scrutiny on the part of an auditor to see not only that subordinates or principles have made fair distributions, but that no one is misled or deceived.

CHAPTER XI

CARRYING CHARGES

§ 62. Interest and Taxes

It is to be noted that the cost of carrying property dates from the time the purchase price is paid or guaranteed. The mere holding necessitates the use and the tying up of capital which otherwise could be earning interest; and capital invested in property is as worthy of its hire as is a contractor erecting a building thereon. Again, every owner of property in civilized countries receives, nominally at least, benefits and protection from one or more governmental bodies, and his property is required to contribute its quota of the cost of providing such benefits and protection. This is paid in the form of taxes. Interest and taxes, therefore, comprise the total cost of holding unimproved property, and this gives rise to the question: Should interest and taxes be included in the cost of property?

The writers on accounting subjects are rather indefinite in their answers to this question. Pixley,* for example, while stating that, theoretically, the cost of real estate should be confined to the purchase price, so that even legal expenses incurred in acquirement should not be included in cost, admits that the usual custom is to include such items and enters no protest against it. Many of the older authors pass the matter by, almost without remark. Recent writers, however, have treated the matter fully, and perhaps no clearer exposition of both sides of the question can be found

*"Auditors, Their Duties and Responsibilities."

than that given by Nicholson in his work on "Cost Accounting."*

§ 63. Interest as Part of Cost

In this country, if a construction company undertakes to build a railway, it is permitted by law to include in construction expenses "interest on loans effected and on notes issued for construction purposes." A similar practice is allowed in other countries.

From this it has been argued that a company buying land for development purposes is entitled to include in the cost of the land the interest it may pay on loans which it makes in order to raise the purchase money. This, however, does not seem to be a logical position, for if interest is charged on such loans, which are practically a part of the purchase money, why should not interest be charged on the entire price?

It should be remembered that the holdings of a concern dealing in real estate are its stock in trade and form its inventory, and are subject to the basic rules governing any other stock in trade. A merchant would not add interest to the purchase price of his goods when taking their cost value in an inventory, nor is it usual for an investor buying stocks, bonds, or other security, to add the interest thereon to the original price and call this total the cost of the securities. Any merchant following such a course would be anticipating his profits—a practice inconsistent with good business.

The fact that an individual or a corporation, not having sufficient money to pay the full purchase price of an article, must borrow the money, does not in any way change the value of the article bought, although the fact that interest must be paid on borrowed money may *apparently* increase

*"Cost Accounting, Theory and Practice," by J. Lee Nicholson.

the cost. On the other hand, if interest on a part of the purchase price is charged to cost, then interest on the whole price should be so charged, for the simple reason that the money which the purchaser invested in property would, presumably, if not so invested, have been used for income-producing purposes.

The fallacy of charging interest on the borrowed money only, may be shown by an example: Suppose a concern finds at the end of a month that it has $5,000 in bank; that $5,000 on a piece of property purchased a year ago is now due; and that it must also pay salaries to the amount of $5,000. It therefore goes to the bank and borrows $5,000. Is there any good reason why the interest on this loan should be charged to the cost of the property? Both the debts are valid obligations; either one of them could be paid without borrowing, but if the money in bank is used for the payment on the land, a like sum must be borrowed to pay the salaries, and interest on such a loan is chargeable to "Income." Who can say to which purpose the bank balance was devoted, or to which the borrowed money?

Possibly the fact that interest on money borrowed for current expenses must be deducted from "earnings," while interest on money borrowed to pay for land may be absorbed in the Real Estate account, and thereby *apparently* increase assets rather than expenses, explains the practice of including such interest in the cost of acquirement.

§ 64. Inventories at Cost

The auditor on inquiring as to the cause of the sudden increase in values shown by the Real Estate account is often told that "the land was valued by three experts, and that the new figures represent the lowest valuation." Still, the land is not yet sold. Again, a conservative merchant who has on hand 1,000 barrels of flour which cost $8 each, would

not enter them in his inventory at an increased price, even though a hundred experts might truly testify that the flour was worth $10 a barrel. Why should a different practice obtain in the case of real estate?

This is one of the questions which must ultimately be decided by the circumstances of each case. As a general rule, especially in companies where real estate forms the main asset, the safe and proper plan is to take the real estate at its actual cost, and to adhere strictly to the recognized principle that inventories should always be based on such cost.

The balance sheet, and therefore the Property account in the general ledger, should always show the actual cost of real estate, that is, the cost of acquirement. Most people, when examining a balance sheet, do not consider interest as a part of the cost, and would therefore be misled to some extent if it were included in the Real Estate account.

The cost of acquiring real estate will properly include those expenditures which materially enhance the value of the property, such as physical improvements; but the mere payment of interest does not in any way affect that value, and should not be treated as if it did.

§ 65. Interest on Cost

There is another phase of the interest question to be considered. When land is bought with the idea of holding it for a future rise in value, the owner must necessarily take into consideration interest on the purchase price. It is not an uncommon thing to hear that a man who bought a piece of real estate ten years ago for $1,000 and sells it today for $1,200, has made $200; whereas interest on $1,000 for ten years at 6% amounts to $600. In such cases there is some reason for considering the interest as a part of the cost, but even then it is a better plan to carry the

interest, and also the taxes, etc., in separate accounts, the total of which, added to the original price, will show the cost at any given date.

On the other hand, when improved property is bought and rented, the owner, in estimating his profits, does not add to the original cost the interest accruing since the purchase price was paid. This indicates that the method of treating interest in connection with cost depends to some extent on the purpose for which the property is held.

Speaking generally, interest and taxes, being fixed and beyond the control of the owner, should be charged against income in the balance sheet, for they represent that which is past, while profits are among the things hoped for. This periodic charging up, however, does not in any way preclude the keeping of such records of these expenditures as will instantly show the true history of any property. Memoranda accounts for this purpose are fully provided for in the property records which are shown in Forms 20 and 21 (§ 26).

In instances where tracts of land are held by development companies for purposes of subdivision, the best practice is to leave out of the books of account all interest on the investment, except, of course, such interest payable as accrues upon mortgages payable, and this interest should be written off to Profit and Loss whenever the books are closed. This avoids adverse criticism, as well as the possibility of misleading the interested parties.

§ 66. Treatment of Interest Charges

The foregoing discussion may be summarized as follows: Interest on purchase money, even though this be borrowed in whole or in part, is not ordinarily a proper charge against cost. Interest on borrowed money, according to the best authorities, may be included in the cost of construction,

during construction or development; but such charges must stop the instant construction is completed, and thereafter all interest becomes a debit, not against "Investment" or "Capital" account, but against "Income." At the same time, the records should be so arranged as to afford full information regarding such items as interest and taxes. In other words, the balance sheet should be based on the cost of acquirement, while the subsidiary records should show also the cost of holding.

§ 67. Depreciation as Affecting Cost

One other matter affects the cost of holding, and that is the depreciation of buildings. This subject presents some complications and requires consideration in some detail. It is therefore treated separately and at length in Chapter XXXII.

§ 68. Taxes

The principles which apply to interest are in a general way applicable to taxes—with the marked difference that the actual payment of taxes on the whole assessed value admits of no evasion. Though a necessary expenditure as well as expense, taxes do not enhance the value of property and should be treated, as a rule, in the same manner as interest.

Possibly, in the treatment of taxes and assessments upon subdivision property, the clearest way is to keep distinct the taxes upon each subdivision for a given year; and at the closing of the books, after calculating the earned or realized profits on this particular subdivision, to deduct from that profit the taxes which apply to the year under consideration. This brings them eventually into the Profit and Loss account, and gives the same final result as if all taxes were charged direct to Taxes account, which also is written off

as a whole to the debit of Profit and Loss account. The plan first outlined has the advantage of showing exactly the net results yielded by each subdivision. (See also Chapter XXXV.)

§ 69. Assessments

The word "assessment" is here used in a limited sense, referring only to such charges as do not necessarily enhance values. The term is, however, frequently applied to the owner's share of the expense of laying pavements, sewers, water mains, etc. In such cases, it is evident that the amount should be charged to Improvements and be treated accordingly, for the paving of a street or the draining of a neighborhood increases directly the value of all abutting properties.

§ 70. Cost of Maintenance and Operation

The case of an office building may now be considered, as differing as widely as possible from unimproved properties. Here the income is from "rent." As to expenditures, we have in addition to those already considered, another and quite distinct class, consisting, first, of repairs and cost of maintenance; and second, of such charges as those for engineer and janitor service, and for light, power, elevators, etc. All these expenditures are necessitated solely by the fact that certain conditions must be complied with before rents can be collected, and they are classified as the costs of maintenance and operation.

This difference, however, in no way affects the principles already laid down in discussing unimproved property, or the procedure to be followed, except that the memorandum accounts in the real estate ledger, dealing with improved property, should show the net income derived from this source.

§ 71. Profits on "Value" and "Investment"

In improved properties another distinction is, however, quite commonly found. The profit on the value of the property frequently differs from the profit on the actual cash investment. This is clearly shown by the following example:

If an office building be bought for \$500,000, of which \$200,000 is represented by a mortgage bearing interest at 5% per annum, and the net rents are \$60,000, the taxes and insurance \$10,000, and the cost of maintenance, repairs, service, insurance, etc., \$15,000, then the net income is: \$60,000 — (\$10,000 + \$15,000) = \$35,000, which is 7% on the cost of acquiring; whereas the return on the cash invested is \$35,000 — (5% on \$200,000) = \$25,000, which is 8.3% on the cash invested.

These figures show the importance of recording clearly and in one place all particulars regarding each piece of property, in such a manner as is provided for in the real estate ledgers.

CHAPTER XII

SALES OF REAL ESTATE

§ 72. Time Sales

From the fact that real property is usually sold with some form of guaranty on the part of the vendor, thereby creating a contingent liability, it is fully as necessary that the records should show exactly the disposition of each property as it is that they show the method of its acquirement and the cost of holding it. The manner of disposition is twofold, viz.: (1) time sales; (2) final sales.

The particulars for time sales are taken from the report of sale (Form 17, § 25) and entered on the books, such entries closing the Real Estate account for the property involved. This, however, does not entirely relieve the accountant of responsibility, for he should see that the abstracts are retained until the final payment is made, and that insurance policies and similar papers are properly indorsed and delivered to the owner or mortgagee, as the case may demand.

§ 73. Final Sales

When property is finally disposed of and completely paid for in cash or its equivalent, it is well to enter on the face of the Real Estate account for the particular piece of property sold, an indorsement in substantially the following form:

> "Deed delivered to .... (name) .... on .... (date) ...., together with abstract, insurance policies, etc." (specifying each paper so delivered).

The making of such entries saves much time later. It is all the more important because such papers are frequently delivered not to the purchaser himself, but to some agent or attorney, so that by the time they reach the purchaser they have passed through several hands; and it is essential that the concern be able to show from its records the delivery of all the necessary papers.

§ 74. Form of Entries Relating to Sales of Property

To illustrate the entries required on selling a piece of property, assume the case of property sold to Richard Haines for $1,200, the cost price being $1,000. There are four distinct methods of payment, viz.: (1) cash sale; (2) mortgage as part payment; (3) payment by cash, note, and mortgage—building to be erected by vendor; (4) sale on contract.

1. If a cash sale is made, the amount of $1,200 will be posted from the cash book to the credit of Property account in the general ledger, and to the credit of the account of this particular lot in the property ledger. This will cause the latter to show a credit balance of $200, which may be allowed to remain until the books are closed and a balance sheet prepared. This amount, with other similar amounts, is then carried to the Gain on Sales account. Or the balance of $200 might be carried at once to Gain on Sales account without passing through the Property account. The Gain on Sales account is eventually closed into Profit and Loss account, as will be described in Chapters XIII to XV inclusive.

2. Suppose that instead of paying $1,200 in cash, Haines makes a cash payment of $500 and gives a mortgage for $700. The cash would be credited as in the above instance, and the journal entry might be formulated as follows:

Mortgage Receivable	$700	
To Property Account		$500
" Gain on Sales		200
For mortgage receivable No. ..... made by Richard Haines as part payment for property No.		

The postings are made to the general ledger, and a new account showing all particulars of the mortgage is opened in the mortgages receivable ledger.

3. Again, suppose that Haines bought the same lot, the concern agreeing to erect thereon a building estimated to cost $600, for all of which Haines is to pay $2,000, made up of a cash payment of $500, a note for $200 payable on completion of the building, and a mortgage for $1,300. The cash entries would be the same as before, and the journal entry would be as follows:

Mortgages Receivable	$1,300	
Bills Receivable	200	
To Property Account		$500
" Building—Richard Haines		600
" Gain on Sales		400

In addition to the entries made in the last case, a new account is opened in the general ledger, entitled "Building—Richard Haines," which is credited with $600, the estimated cost of the building. This account will be debited with expenditures on account of the building as they are made.*

Care should be taken to see that the estimated cost of the building is for an amount sufficient to cover the entire cost of the building, for there is sometimes a tendency to make the estimate too small for the sake of increasing the apparent profit on the sale. This will be considered further

*The transaction mentioned under (3) might be criticized from a business point of view. However, such sales do occur frequently and in various localities, and this case is discussed here simply to show how to deal with the problem whenever it arises.

when we take up the accounts appearing on the trial balance. (See Chapters XXV, XXVI.)

Another point to be considered is the note given by Haines, which is payable on completion of the house. This note should be drawn to fall due on a fixed day, which should be set sufficiently far ahead to insure ample time for the completion of the building.

4. Suppose the property were sold on "contract," Haines buying the property for \$1,200; \$200 in cash and a contract for the balance. The transaction is entered in the journal as follows:

Contracts	\$1,200	
To Property Account......................		\$1,200
For contract No. .... made with Richard Haines on property No.		

After posting to the general ledger, a new account would be opened in the contracts sub-ledger, and all particulars entered therein as shown above. The cash payment in this case is credited to "Contracts."

It will be noted that in the case of a contract the journal entry is for the total amount of the purchase, the first cash payment being credited to Contracts (not to Property account); while, in the case of a mortgage, the journal entry is for that part of the purchase price remaining unpaid. Although this appears simple, the writer has found a number of bookkeepers who have difficulty in keeping this distinction clearly before them, and who are therefore always in some doubt as to what account should be credited with the cash payment when a portion of the purchase price is represented by some form of deferred payments.

To emphasize this matter, if cash and a mortgage are given by a purchaser, this first cash payment (which added to the amount of the mortgage, makes the total price) is to

be credited to Property account. In the event of a sale with part cash under a contract, the amount of the first payment is shown on that contract, which is not the case with a mortgage. As the contract shows on its face the total amount of the principal, this amount is debited to the account of the contract, and *all* payments, from first to last, must be credited to the contract.

§ 75. Legal Expenses

It is the rule in some offices to charge each mortgagor with a fixed sum to cover the legal expenses incurred in obtaining an attorney's opinion on title, in drawing the papers, etc. As this amount increases the principal of the mortgage on one side, and is credited to Legal Expense, it may well be included in the journal entry covering the transaction.

§ 76. Surrender of Contract

A word of caution may be given as to the importance of seeing that all proper formalities are complied with before a deed is delivered. This applies not only to the receipt of the actual consideration, which may involve the execution of a mortgage, but also to the surrender of any outstanding contract.

It has been shown that a contract carries with it an obligation on the part of the owner of the land to convey title to it upon the fulfilment of certain conditions. Such contracts are usually transferable, and before delivering a deed, the owner should receive back the original contract in order to insure him against a subsequent claim thereunder. If this contract is lost, the purchaser should give a written undertaking stating that the deed is received in completion of the said contract, and absolving the owner from all further liability. It is a safe practice to insert in

such a deed a clause stating that it is issued in accordance with the terms of a specified contract, especially when the original contract has been transferred by the original purchaser, who might, in some states, present a claim against the vendor.

It should be noted, however, that the custom of returning the original contract to the owner is by no means universal, and where the custom does not exist, it is obvious that the above precautions do not apply.

CHAPTER XIII

PROFITS FROM REAL ESTATE SALES

§ 77. Definition of Profits

The word "profit" is variously defined according to its use in general business or in economics; but the particular definitions of this term in connection with real estate accounting are:

1. Excess of selling price over original cost.
2. Advantage (gain) resulting from the employment of capital, the corresponding gain from labor being known as wages.

§ 78. Sources of Profits

It has already been shown that real estate may perform a number of distinct functions, and it follows that profits on real estate may arise in a number of different ways. Among the principal sources are the following, which correspond to the functions already discussed:

1. Profits from sales
   Gains resulting from bargain and sale.
   Interest on deferred payments.
2. Profits from rents
3. Miscellaneous profits
   Gains arising from enhancement of values; from consumption of assets, as in mining; from crops, profits accruing indirectly from the use of land for such buildings as factories, furnaces, etc.; profits pertaining to a broker or dealer; and profits obtained indirectly from the use of borrowed money secured by real estate.

In regard to each of these the following questions must be answered:

1. From what source do the profits come?
2. How can the amount of profits be determined?
3. Having determined this amount, what disposition should be made of it?

§ 79. Profits from Sales

These profits are evidently the difference between the cost price and the selling price. There are, however, certain questions to be considered in determining just what these two prices are, for the amount actually paid for a piece of property may not represent the cost of that property, and the amount actually received from a purchaser may include, besides the purchase price, interest, taxes, and insurance, and hence may not be the true selling price.

§ 80. Cost Price

The original consideration for property may have been entirely cash; or cash in part, with mortgages in some form. Beyond this there are taxes, insurance, interest, and improvements to be considered, and, after the proper entries have been made, the amount charged against the property will represent its actual cost at the time of the sale.

§ 81. Selling Price

As already suggested, the selling price also may involve considerations other than the actual purchase price. It frequently includes taxes paid or to be paid, and insurance paid in advance. In such cases the amounts included in these accounts should be treated in the same manner as similar items under cost price. If taxes have been included in the cost they should be included also in the selling price; otherwise, they should be credited to Taxes account.

§ 82. Earned Profit

If the sale is for cash, the difference between the cost and the selling price, as these terms have been qualified above, will show at once the profit which is *earned* and *realized*. The entries required are simply the posting of the amount received, from the cash book to the credit side of Real Estate account. If the transaction has yielded a profit, a credit balance will result to this account, which is best disposed of immediately.

The balance, or profit, may, theoretically, be carried direct to Profit and Loss but it is preferable to carry all such items into a special account, "Gain on Sales" or "Profits," and at the close of the fiscal period to carry the balance of this account to Profit and Loss. (See §§ 235, 236.)

The journal entry required to transfer the credit balance of the Real Estate account to Profits would be as follows:

Real Estate....................................	$......	
To Profits................................		$......
For profits earned on sale of property No.		

In this instance and in those which follow, the gain from a sale, when carried to Profits account, may be carried to Profit and Loss at the end of the fiscal period, while the same profit carried to Gain on Sales should be treated in the manner described in Chapter XX.

§ 83. Mortgage Assumed by Purchaser

It very frequently happens that a transaction involves more than the exchange of cash for real property. There may be a mortgage or some other lien which the purchaser assumes; or, more often, the purchaser may give a mortgage as a part of the price (§§ 52, 53).

In the first instance the journal entry should show that the seller is relieved of any obligation which is assumed by the purchaser, and in many cases this entry should include some mention of interest on the mortgage. It may be overdue, or it may be the sum which has accrued since the last interest date, as in the case of property sold on the 1st of August subject to a mortgage payable on which interest had been paid up to the 1st of June.

In case a mortgage were assumed by the purchaser, the journal entry on the books of the seller would take the following form:

Mortgages Payable..........................	$......	
To Real Estate......................		$......
For mortgage No. ...., assumed by ....on the purchase of property No.		

In the case of overdue interest assumed by the purchaser, the following journal entry would be made by the seller:

Mortgages Payable..........................	$......	
Overdue Mortgage Interest Payable...........	......	
To Real Estate......................		$......

If accrued interest not yet payable be included, the entry would be:

Mortgages Payable..........................	$......	
Mortgage Interest Payable..................	......	
To Real Estate......................		$......

§ 84. Large Cash Payment—Balance Secured by Mortgage

In those cases where a part of the purchase price remains unpaid and is secured by a mortgage, the situation becomes rather more complicated, especially as to the meth-

ods of entering the profits. No one rule can be made to apply to all such cases, and each transaction of the kind should be carefully examined by the accountant.

Of such cases the simplest is where the purchaser makes a substantial cash payment and gives a mortgage for the balance. The ratio between the cash payment and the mortgage then determines the proper course to be followed. If, for example, half the purchase price is paid in cash, the mortgage is secured by property worth twice the amount of the mortgage, and such mortgages are usually regarded as first-class securities. It would therefore be safe to place the mortgage among the assets at its face value. In other words, although the entire consideration has not been paid, we can regard the sale as completed and the profit as fully earned. The mortgage receivable can be treated as a *bona fide* asset for its face value.

§ 85. Small Cash Payment—Balance Secured by Mortgage

It frequently happens, however, that only a small cash payment is made, the greater part of the purchase money being secured by mortgage. In such a case the safest method is not to consider the transaction as entirely closed, nor the profits as actually earned. For example, if only one-tenth of the purchase money has been paid, and nine-tenths is secured by mortgage, that mortgage could not, as a rule, be considered good marketable security, as the amount of the debt is too near the value of the security and the mortgage has but a small "margin." Should the mortgagor fail to pay the debt before it has been substantially reduced, and should it be necessary to resort to legal proceedings in order to recover the title, the expense of such proceedings would, in many cases, swell the amount of the mortgage to a sum equal to, or greater than, the original debt.

§ 86. Gain on Sales Account

In cases where mortgages are taken in part payment, the apparent gain should be carried to the Gain on Sales account (§§ 79-82). The handling of this account is treated more fully in Chapter XX.

The entries made on the cash book should credit Real Estate with the amount of cash received, and the journal entry is as follows:

Mortgages Receivable..............................	$......	
To Real Estate........................		$......
" Gain on Sales......................		......

§ 87. Sales on Contract

It is a practice common probably throughout the United States, for owners of real estate, especially corporations whose business it is to buy, develop, and dispose of real estate, to sell their property under some form of agreement, which for the sake of brevity we will call a "contract." The subject of contracts is more fully discussed in Chapter XVII. In a great majority of cases, the first payment is small, and the contract may carry with it no *obligation* on the part of the purchaser to complete the purchase. In such an instance, the general procedure is the same as in the case of mortgages on which a small payment has been made. The journal entry would be in the following form:

Contracts	$......	
To Real Estate........................		$......
" Gain on Sales......................		......

§ 88. Exchange of Properties

Another method very frequently used in disposing of real estate is in the nature of an exchange, the owner selling his property and taking in payment therefor other prop-

erty, with perhaps some cash payment in addition. The entering of such a transaction on the books is a simple matter, and takes the following form in the journal:

Real Estate..................................	$......	
To Real Estate.......		$......
For exchange of property No. ...... for property No.		

The most important point for investigation in such transactions is the value at which the new property is taken, for it sometimes happens that matters other than the actual cash value of the property are taken into consideration when the exchange is made; and the amount allowed for the property received may not indicate its market value, since it is not unusual to place a higher valuation on property when it is paid for "in trade" than would be asked if the consideration were cash. For instance, the owner of a piece of property may be willing to give it in exchange, at less than its actual value, for other property situated in a neighborhood in which he is interested, or which is suitable for some special purpose which he desires to carry out. It is evident that in such a case the property so acquired may be brought on the books at a figure in excess of its market value.

§ 89. Appraisal of Property

The appraisal of any real estate is, of course, merely an expression of opinion, and the only true measure of its value at a given time is an actual sale, or a *bona fide* offer of cash or its equivalent. At the same time, before passing such an entry as that described, an accountant should satisfy himself that the property taken on the books, to the best of the information obtainable by him, is taken at a fair valuation. This valuation, of course, should never

exceed the price actually paid for the property. In other words, if an owner takes property in exchange and allows $1,000 for it, it should be entered at this figure even if he considers it worth $1,500. The excess of $500 should not be put on the books until an actual sale of the property has proved that such value exists.

§ 90. Development Properties

The treatment of profits accruing from the sale of suburban tracts or development properties (that is, land bought in considerable quantities, subdivided by the owner and sold off in comparatively small lots) is treated in detail in Chapter XXIII.

§ 91. Hidden Profits

In some cases the profits from real estate may be said to be hidden — a condition most clearly explained by an example from actual practice.

Four partners together bought a tract of 3,000 acres of land, for which they paid $15,000. This was held for a period, during which the value of the land materially increased. The tract was then platted, and, after deducting roads and waste land, 500 farms of 5 acres each were laid off. The immediate minimum selling price for these was estimated at $100 each, or $50,000 for all. The four partners formed a corporation, transferred the property to it, and issued capital stock in payment for the property to the amount of $50,000, and this stock was divided equally among them. To provide for current expenses, each incorporator paid in a certain sum, which was treated as a current loan and placed to his credit. As farms were sold, the proceeds were used in making roads and other improvements, and after a few months it was found possible to sell the farms at prices ranging from $600 to $750 each.

It will readily be seen that the conditions in this case differ radically from those previously considered, and that the results of this difference are far-reaching. So far as the company is concerned, the cost of the land equals the amount of capital stock issued. The partners, however, sold the land to the corporation and received $50,000 worth of stock in exchange, thereby realizing a profit of $35,000 on the transaction. In preparing their returns for the federal income tax, it would be necessary for each partner to report his individual share of this gain.

§ 92. Anticipated Profits

The foregoing illustration is not given as an example to be followed, but merely to illustrate the complications which may arise. In fact, the wisdom of anticipating profits in this way is doubtful, and such a method should not be generally followed. Even in the instance given, although in the form of a corporation, it was for most practical purposes a partnership, and the same results could have been obtained if the company had been capitalized for the cost of the land and the improvements made or contemplated. But the main object of the company, besides the avoidance of individual liability in warranting titles and in various other ways, was to obscure or hide from the public the original cost of the land.

CHAPTER XIV

PROFITS FROM RENTS

§ 93. Rent

For the accountant, rent means a compensation payable at some stated time or times for the possession and use of (but not the title to) property for a definite period.

This definition must sometimes be developed further, for the term is not infrequently used in a somewhat lax manner to mean more than payment for the use of property. In some forms of contract for sale on instalments, the agreement is called a "lease" and the periodic payments are referred to as "rent," although, if the transaction is completed, they really form a part of the purchase price. These questions are discussed under the head of "Contracts" in Chapter XVII.

Again, the word "rent" is sometimes used to indicate the consideration given for mining rights, which is in the nature of a royalty, for it pays not for the use or hire of the material mined, but for the material itself, which becomes the property of the lessee on such payment being made or agreed upon. A somewhat similar use of the word is occasionally found in connection with hire purchase agreements.

The particular kind of rent considered in the present volume is covered by the first definition given above, and by the every-day, non-technical use of the word, meaning the amount a tenant pays to his landlord for the right to use and occupy land, including in most cases a dwelling or factory, or other improvements on the land. Such rent

constitutes the return which an owner receives for the use or hire of his property, whether it be land, building, machinery, or any other property, real or personal.

§ 94. Leases

The amount, duration of occupancy, time of payment, and other particulars, are frequently set forth in a lease. In a very large number of cases, however, no such paper is drawn and the agreement is merely a verbal one, as in the case of small dwellings and tenements, where the rent is paid at short intervals, as a week or a month, and where the arrangement may be terminated on short notice by either the landlord or the tenant.

In a general way it may be said that the purpose of a lease, beyond stating the terms to be observed by the parties, is the protection of both the landlord and the tenant. The landlord is protected because the tenant agrees to make stipulated payments in a definite manner, and such agreements can usually be enforced through the courts, although the method of procedure and the practical value of the remedy vary with the locality. The tenant is protected because he is assured—if he fulfils his part of the contract—of the use of definite property for a definite period at a definite price.

The law and the practice regarding leases vary in each country and in each of our states. It would be useless to attempt to follow these variations further than to remind the accountant that it is a part of his duty to familiarize himself with all local requirements as to leases.

While it is not the duty of an accountant to act as appraiser, it *is* his duty to see that leases are drawn and executed in conformity with statutory requirements. This is especially true in the United States, where owners of real estate, when leasing their property, frequently rely upon

printed forms, of more or less excellence, bought by the dozen from the nearest stationer, dispensing with the services of a legal adviser until they find themselves at the court-house door.

§ 95. Gross Rent and Net Rent

In real estate records, the expressions "gross rent" and "net rent" frequently occur, corresponding in general to the "gross profits" and "net profits" of a mercantile enterprise, but too often used in a vague and indefinite sense.

The term "gross rent" properly designates the total amount received by the owner from the tenant or lessee for the use of certain property. In order to obtain this gross rent, however, the owner is frequently obliged to make certain outlays, and the difference between the gross rent and these necessary outlays constitutes the "net rent."

The exact nature of these outlays cannot be given, for they vary according to local laws, the nature of the property, and the terms of the agreement. The necessary outlays in the United States usually include taxes, insurance, and repairs.

In apartment or office buildings the following expenses must usually be added: light, water, heat, power, and wages.

The essential point is to include *all* the necessary expenditures, in order to obtain the net rent.

§ 96. Net Rent and Net Returns

Strictly speaking, the other closely related charges, such as interest and depreciation, do not affect net rent, although they must be included when considering *net returns*. The fact that an owner is obliged to pay interest on money which he has borrowed on a mortgage secured by a piece of property, in no way affects the net rents; for the existence of the mortgage does not of necessity affect the value of the

property, though it may materially affect the returns obtained by a purchaser on the amount which he has to pay for the property.

As a simple example, take an office building worth \$200,000, yielding gross rents of \$16,000 a year, and forming the security for a mortgage of \$100,000, bearing interest at the rate of 6% per annum. The gross earnings of \$16,000 are entirely independent of the mortgage and constitute 8% of the value. In order to buy the property, however, a purchaser need invest in cash only \$100,000 and assume the existing mortgage. The result is that he

receives gross rentals of......................	\$16,000
From which he pays interest at 6% on \$100,000..	6,000
Leaving a gross return of.....................	\$10,000

which is a gross *return* of 10% on the investment, although the gross *rent* is only 8% on the value.

In other instances, e.g., where the land is occupied by buildings not commensurate with its value, the rate of interest may exceed the percentage of gross rentals, and the result obtained will be opposite to that shown in the above example. The principle, however, remains unchanged.

It is impossible to do more than indicate the factors which must be considered in determining the net rents, as in practice they depend largely upon local values and conditions.

§ 97. When Should Rents Be Entered?

No mention of provision for entering rents on the books of account until those rents are collected has yet been made, and no one general rule governing the proper procedure can be stated. The course to be followed is to be determined by (1) the laws governing each case, and (2) the class of tenant.

In England, for example, it is the general practice to credit the property and debit the tenant with rent as it falls due, and to credit the tenant when payment is made. In that country the law provides the landlord with such means of enforcing his claims that he is usually reasonably sure of making his collections.

On the other hand, in our own Southern States, the laws concerning delinquent tenants are less severe, and homestead exemptions are usual. Further, a large amount of rental property is occupied by colored people of somewhat migratory habits, and the flitting tenant is as common as the flitting cardinal-bird, and quite as elusive. In such cases it is misleading and a waste of labor to follow the above procedure, and frequently the cash actually collected is the only asset. Rent remaining unpaid is not only uncollected, but uncollectible, and its inclusion in a profit and loss account may lead to a similar inclusion of other equally worthless and fictitious assets.

These conditions have naturally brought about the general plan of making rent payable in advance, usually by monthly instalments. Such being the case, circumstances must govern procedure. It should not be forgotten, however, that even if rent is not charged against the tenant here as it is in England, there should always be a rent ledger so kept as to enable a concern to determine quickly all arrears which may be due. When preparing financial statements, the amount of such arrears may properly be shown in a footnote.

§ 98. Rents from Mines and Similar Sources

The treatment of rentals from mines pertains to the accounts of mining companies rather than to those of a real estate concern, and need not be considered in great detail at this time. As has already been stated, the periodic pay-

ments are not, strictly speaking, rents, but are a consideration for something pertaining to the natural land, which may be the coal or other mineral deposits under the surface, or the natural product of the soil above the surface, as in the case of timber lands; or the removing of certain parts of that product, as in the case of turpentine and rosin, tapping for maple syrup, cutting camphor trees, etc.

The value of all such lands is composed of (1) the value of the deposit or growth; (2) the residual value of the land after such deposit or growth is removed.

Inasmuch as the rents or royalties paid in these cases are the consideration given for the outright purchase and consumption of principal, they should not be credited, in the first instance, to Profits, but to Real Estate. When they become equal to the cost of the property, all further rents may properly be credited to Profits.

§ 99. Treatment of Mining Rents

Beyond the suggestions already given, it is difficult to generalize in the matter of rents from mines and similar returns, for each instance must be worked out for itself, the residual value being so variable. For example, deep mining does not affect the value of the land for agricultural purposes; while quarrying, clay working, and other varieties of open mines leave the land in such form as to render it useless for any subsequent purpose.

For an example of the consumption of growth on the land, consider the yellow pine forests of the Southern and Southwestern States. Here there are three distinct elements of value appealing to three distinct classes of investors, viz.:

1. The turpentine rights, which cover only the "boxing" of the timber and are useful only to naval stores operators.

2. The trees themselves, which, after having been "boxed," retain their value for logging purposes.
3. The naked land, which in many cases is more valuable for agricultural purposes after the turpentine and logs are removed than it was before.

In such an instance, the total cost of the land may be apportioned to these three divisions without difficulty, for such land is almost invariably surveyed and examined by experts before purchase. If the rent obtained for turpentine rights exceeds the portion of the cost assigned to turpentine, such excess is profit; if it falls short, the deficit may be regarded as a loss, or, under some circumstances, may be added to the cost of the land and timber. The same principle is followed with the logging payments, and the naked land is left with its proper proportion of the cost.

CHAPTER XV

PROFITS FROM ENHANCEMENT OF VALUE AND FROM MISCELLANEOUS SOURCES

Profits from Enhancement of Value

§ 100. Increased Value of Mineral Lands

In the case of mining rights, there frequently arises a need for reappraisals on account of fresh deposits being found, or on account of improved facilities becoming available, which render possible or profitable the working of deposits not included in the original valuations. Such increases should, of course, be shown in the accounts, but the matter of revaluations must be approached in a conservative and fair-minded manner. These increases are frequently somewhat problematical, and any doubtful portion of the increase should be shown, not in the general Property account, but in a special reserve account opened for the purpose and finally disposed of either as a gain or as a loss, as the circumstances may determine.

§ 101. Enhanced Real Estate Values

By this is meant an increase in the market price of real estate not sold but still owned by a concern. When considering this source of profit, the manager should clearly recognize the distinction between property owned and offered for sale by a real estate concern, and the real estate owned by a mercantile or manufacturing concern, consisting of warehouses or factories necessary for the conduct of business, but not, in the ordinary sense of the term, for sale.

It must not be forgotten that an enhanced valuation merely means that those making that valuation are of the opinion, or have the faith, that such values could be realized. There is yet to be found a better definition of faith than that which has been accepted for nearly two thousand years—"the substance of things hoped for, the evidence of things not seen." This indicates with singular accuracy the proper course to follow; the increase in values is something hoped for and believed in, but *not* realized. At the same time, it may be fair to show some evidence of this hope by a proper entry on the balance sheet.

The proper place for anticipated profits to appear is in a prospectus, a document whose very name indicates that it describes the good things which are expected to come. On the other hand, a balance sheet states conditions existing at a given moment which has already passed. While it may be a matter of regret that the statements of the balance sheet do not always fulfil the predictions of the prospectus, it is of importance to the stockholders that any such discrepancies in values be exhibited clearly, and if it is necessary to anticipate profits in order to hide such discrepancies, the investment is liable to prove a failure.

§ 102. Fluctuations in Real Estate Values

When considering the wisdom of placing on the books any values of real estate other than the cost price, it must be remembered that, while real estate is among the most stable of assets inasmuch as it seldom entirely disappears, it is peculiarly sensitive to fluctuations in its selling value. Its very immobility is one cause of this, for neighboring improvements or changes which are beyond the control of its owner may cause its value to vary considerably.

Again, real estate is not a necessity of life in the same sense as food products or clothing, and the real estate mar-

ket is one of the first to suffer in times of depression or panic, fluctuating to a degree equalled only by those articles which are obvious luxuries. Such times of panic are the very occasions when it may be necessary to realize on assets, and this realization will undoubtedly puncture any inflation which may exist.

§ 103. Bank Practice

An example, or rather a series of examples, which may be instructive for too optimistic a management, may be found in the treatment of real estate by banks and trust companies throughout the country, which for the most part do not show their real estate assets at any figure above cost, and, owing to liberal allowances for depreciation, frequently show them below cost.

The policy proper to a bank may differ, of course, from that of the ordinary business firm, but it is only natural for a banker from whom a concern borrows, to apply with more or less stringency the rule that "what is sauce for the goose, is sauce for the gander."

§ 104. Accounting Treatment

The question of entering on the books of account actual or supposed increases in value of real estate before they are realized, is one which accountants are frequently forced to consider. It is obvious that no such increase of assets should be allowed on mere hearsay evidence, or on the personal opinion of an individual.

In those cases where the claim for an enhanced value is supported by the report of properly qualified appraisers, or by a *bona fide* offer of purchase, it is sometimes considered advisable to show this increase on the balance sheet, where it may be the proper foundation for an increase in a line of credit or in the Surplus account, or possibly it may warrant

the issuance of a stock dividend. It can seldom, if ever, be properly included in Profit and Loss account, and it cannot afford a proper basis for the declaration of a cash dividend; for, in the case of a mercantile or manufacturing concern, land is usually held incidentally, as it were, and its increase in value is not profit arising out of the operation of the business. Such a profit would be the proper basis for dividends, but an increase in real estate values would not ordinarily be so—unless these profits were actually realized.

As an argument for making entries showing enhanced values, it is sometimes stated that property carried on the books at a certain figure is covered by a mortgage securing an amount greater than its original cost. Even if such were the case, it merely shows that another person had faith in the concern and loaned money to it, accepting the property as security. The concern did not realize on the value and its treasury did not receive it.

§ 105. Rights of Stockholders

It may be suggested, in connection with increased real estate values, that there is another point of view to be considered—that of the stockholders, for whom the officers of the company are, in fact, trustees.

Let us assume that a manufacturing concern has for a long period owned its land and buildings, and has increased its business to such a point that no further increase can be made unless additional capital, either fixed or floating, is provided. During this period of success, the land has increased in market price to such an extent that it would now form ample security for a loan of sufficient size to obviate the necessity for a further issue of capital stock, although its cost price as shown on the ledger does not indicate this.

It will generally be conceded that in such an instance

the directors might be derelict in their duties if they failed to avail themselves of this appreciated value; and having availed themselves of it, the appreciation should appear in the accounts. If they failed to show it, there would exist something very nearly akin to that bone of contention, a "secret reserve"—a matter not for discussion here.

§ 106. Effect of Enhanced Real Estate Values on Rent Charges

There is another aspect of the above conditions which is too frequently overlooked, and which can be made clear by an example. A mercantile concern paid $60,000 for the building in which it transacted its business. Owing to improvements in surrounding properties, the actual value of this building increased in the course of three years to $150,000, evidenced by an offer for the property at that figure. It had been the custom of this concern to make a rent charge based on 8% of the cost of the property, or $4,800 a year. As soon as it is possible to obtain a higher price for the property, this basis of calculation becomes erroneous, for when the value of $150,000 was reached, the concern was paying (on the same basis) a rental of $12,000 a year—which might be far in excess of what the business warranted.

It is evident that if property can be sold for $150,000, that sum is tied up in it, and that amount fixes the proper rent charge. The wisdom of paying such a rent depends, on the one hand, upon the earning capacity of the business, and, on the other hand, upon the contingency of such further increase in value as will refund the excessive rent. At the same time, as soon as a concern relies upon increases of real estate values for its profits, it is to some extent engaging in real estate business as well as in that for which it was created.

§ 107. Summary

The entire question as to the treatment of profits from enhanced real estate values not yet realized may be summarized as follows:

1. In the case of a real estate concern whose chief asset is its real estate, such appreciation should not be added to the cost price.

2. In the case of a concern engaged in some other kind of business, it may, under some circumstances and with proper restrictions, be permissible or even necessary to show such appreciation, but it should be stated so clearly that no one will be deceived as to the nature of the profit.

3. In the latter case, such profits should never be shown in the Profit and Loss account as arising from the operation of the business, but should be carried to a Reserve and Surplus account.

Profits from Miscellaneous Sources

§ 108. Profits from Money Borrowed on Real Estate

Profits from money borrowed on real estate and reinvested do not necessarily affect the accounts of a real estate concern as such, for the money so borrowed may be invested in any enterprise or security. No discussion of such profits, therefore, is necessary here.

§ 109. Operation of Manufacturing Properties

It is a common occurrence for a real estate concern to find itself the owner, by sale or exchange, or more often by foreclosure proceedings, of certain properties whose values can be maintained only by operation. In a general way, such properties may be divided into two classes, viz.: (1) manufacturing or mining, (2) agricultural. The distinction here made is perhaps an artificial one, for the difference in

treatment depends less upon the nature of the business than upon the amount of detail involved.

In operating any property of the first class, be it a factory, mill, coal mine, brick-yard, or other enterprise involving numerous expenditures and detailed accounts, a separate set of books should be opened, such as would be required were the business owned by strangers.

The accounts of the real estate concern should show in one account the principal invested, and in the other account the cash advanced to or received from the business. At the close of each fiscal period the books of the business should be closed in a proper manner, inventories taken, balance sheet and accompanying statements prepared, and adjustments made to the Principal account if there have been changes in value. The final profit should be carried into the general Profit and Loss account. The point to be emphasized is that in all such cases the general books of the real estate concern should be kept free from all details of operation.

§ 110. Operation of Agricultural Properties

Agricultural properties, such as farms, orchards, and plantations, do not, as a rule, involve so many details. Such properties are usually placed under the management of a superintendent skilled in that particular branch of work. The payments are comparatively few, consisting of monthly pay-rolls, bills for fertilizers, tools, etc., and the receipts consist of annual returns from the crops. Under these circumstances, all the business may be carried on the general books of the concern, and, if necessary, a sub-ledger containing the account of each piece of property so operated may be opened.

As an example, let us consider the case of a large concern which had loaned considerable sums secured by mortgages on orchards and, owing to bad seasons, was obliged

to foreclose on a number of them. It was necessary either to maintain the orchards or lose the chief value of the property, which lay in the trees rather than in the land and improvements.

This concern engaged a traveling superintendent, who installed a resident farmer in charge of each orchard, this latter approving all expenditures. These were charged monthly, through a special column in the cash book, to "Care of Orchards," and each item was posted to the account of the particular orchard concerned, which was opened in an "orchard" sub-ledger, the superintendent's expenses being prorated among all the properties in his charge. All receipts were treated in a similar manner.

The result was that the general ledger always showed the totals of the orchards as a whole, while the sub-ledger showed the result of each orchard. The general ledger enabled an annual analysis to be made, showing the total amounts expended respectively for management, labor, repairs, fertilizer, picking, and tools.

In such accounts care must always be exercised to see that the items charged to repairs and improvements are properly distributed. The distribution of these charges must be governed by the principles laid down in Chapter X.

§ 111. Operation of Orchards—Increase in Value

Owing to risks incident to all agricultural enterprises, the greatest conservatism must be observed in bringing on the books any enhanced values on account of the growth of trees, for the trees themselves may be destroyed at any time by pests, drouth, cold, or by some enemy yet undiscovered. The safe course, therefore, is to write such enhanced values on the books when they are realized by a sale of the property, observing the rule laid down elsewhere that Property account shall represent actual cost of land

and improvements. Clearing new land and planting new trees are examples of improvements, but new trees planted in place of those which have died are renewals, not betterments.

§ 112. Showing Profit on Annual Statements

Instead of closing the operating accounts each year, it is sometimes wiser to carry forward the balance from year to year, particularly in the case of a young orchard not yet in bearing. These totals may appear separately in the balance sheet in some manner which shows so clearly the nature of the asset that no one can be misled. While such a course increases the amount of the asset on the books, it represents actual expenditures, and is quite distinct from an increase based on an estimated enhancement in value.

A common difficulty in preparing annual statements showing the exact conditions arises from nature's indifference to fiscal years. Peaches will ripen in early summer, apples in the fall, and oranges in the winter; so that, whenever a balance sheet is taken, there is a probability that there will still be on the trees some unpicked or unripened crop on which it is extremely difficult to place a value. The Income account is, however, entitled to such credits when they exist, and a conservative estimate of any ungathered crops should be included in the account.

§ 113. Profits from Crops Other than Fruit

Profits from crops other than fruit so seldom affect real estate concerns that only a reference to them is necessary. Land and development companies are sometimes brought in touch with these profits in connection with demonstration farms and colonies, in which event special accounts are usually kept by those in charge of the farm work, rather than by the real estate office.

CHAPTER XVI

TIME SALES—MORTGAGES

§ 114. Time Sales

It is probably true that cash sales—the simple exchange of real estate for currency—form a very small proportion of the vast number of transfers of real estate which take place annually in the United States.

This being so, the sales for some consideration other than currency constitute the great bulk of the realty sales of the country and are of sufficient importance to require special consideration. Such transactions are variously named, as sales on the instalment plan, sales on deferred payments, etc., etc. For the sake of simplicity, it is proposed to consider them under the generic title of "Time Sales." It may be that this expression cannot be found in the dictionaries, but it is commonly used by those dealing in real estate, and is descriptive and appropriate. In this book, therefore, the expression "Time Sales" is used to include all those transactions in which time is allowed to complete the payment of the consideration.

§ 115. Classes of Time Sales

Time sales may be divided into the following classes:

1. Sales where the vendor conveys title, a part of the purchase money being secured by a *mortgage* made by the purchaser to the vendor.
2. Transactions in which the vendor *agrees* to convey title to the purchaser upon certain stipulated conditions being fulfilled. The forms for such agree-

ments are numberless, but for the sake of brevity they will all be classed here under the term *contracts.*

3. The purchase of an *option* on real estate.
4. The placing of deeds, etc., in *escrow,* to be delivered when certain specified conditions have been complied with.

§ 116. Mortgages

From an accountant's standpoint, the term "mortgage" may be defined as the pledging of property, frequently real estate, as security for the repayment of a specified sum of money at a specified time, together with interest thereon calculated at a specified rate and payable at a specified time and place. If the condition be complied with by the maker of the mortgage—the mortgagor—the pledge becomes void.

The forms of mortgages and the laws governing them vary so greatly in the various states that only such general features of mortgages can be considered here as bear directly on accounts. As a rule, the form of a mortgage is that of a deed conveying the fee simple, but there is always preserved to the mortgagor an "equity of redemption"; and before considering mortgaged land as having become the property of the mortgagee, the accountant must satisfy himself that this equity of redemption has in some legal manner been foreclosed, forfeited, cancelled, or surrendered. This is usually all that an accountant need ascertain on this question, for matters beyond this belong rather to the legal than to the accounting profession. An outline of the entries necessary to bring mortgages into the accounts is given in Chapters XII and XIII.

Minor modifications in the form of a mortgage may appear, according to the ideas of the attorney drawing the document. None of these modifications affect the account-

ant, whose principal interest is centered upon the debt which is secured by a mortgage and which represents the consideration to be shown on the books of account.

In order to perform his duties properly, however, an auditor must be familiar with the general and local requirements governing the particular mortgage which he is examining, and he should be able to say whether or not the legal requirements have been complied with.

The principal legal requirements may be stated as follows:

1. The correct description of the mortgagor as to name, residence, and civil condition.
2. The proper description of the mortgagee.
3. The proper insertion of dates wherever necessary.
4. An accurate and sufficient description of the property covered.
5. The witnessing and the execution of the document in accordance with statutory requirements.
6. The proper recording of the document when that is necessary.
7. An examination of the notes accompanying the mortgage, to see that they are properly dated and executed and conform to the body of the mortgage.

§ 117. Mortgage Notes

The form of mortgage is purely a legal matter and needs but little consideration here. The notes secured by the mortgage are, however, an entirely different matter and require discussion in some detail, for it is with them that the accountant is chiefly concerned. Generally speaking, these notes may be divided into two classes: (1) interest-bearing, (2) non-interest bearing.

$........... Jacksonville, Fla.,................., 191..

.... after date, without grace, for value received, the undersigned promise.. to pay to the order of..................

....

.... Dollars ($...........) together with interest thereon at the rate of ...... per centum per annum until maturity, said interest being payable................................ according to the tenor of .... interest coupon notes of .... Dollars ($...........) each, attached hereto and bearing even date herewith, both principal and interest coupons payable at................................. .... in United States gold coin of the present standard of weight and fineness or its equivalent.

Each maker and indorser waives the right of exemption under the Constitution and laws of Florida, and each maker and indorser waives demand protest and notice of maturity, non-payment or protest, and all requirements necessary to hold each of them liable as makers and indorsers.

It is further agreed that the undersigned shall pay all cost of collection, including a reasonable attorney's fee, on failure to pay this note, or any interest coupon, at maturity. This note shall bear interest at the rate of Ten (10) per centum per annum, from the date of maturity until paid.

This note, and also the interest coupons attached, are to be construed according to the laws of the State of Florida, where they are executed, and are secured by a mortgage on real estate, executed under even date herewith to the payee of this note.

Upon failure to pay any interest coupon on this note, when due, or if any of the conditions and requirements in said mortgage deed be not complied with, this note, at the option of the holder, shall become due and payable.

....

....

Form 42. Mortgage Note—Interest-Bearing

1. There are, of course, many varieties in the forms of notes in each class, but the note shown in Form 42* illustrates the essentials of the interest-bearing note.

In some instances, the words "on or before" are inserted at the beginning of the note. This gives the maker the right to pay in full at any time, and if such an addition is made to the note, care should be taken to see that it is shown on the records in the books. Attached to this note are the necessary coupons (Form 43). Attention is called to the size of this coupon (approximately 3½ × 5 inches), which in practice is much more convenient than the small coupons generally used. Each coupon is securely attached to the body of the note, and is torn off along the perforated line as it becomes due.

2. It will be seen that the note shown in Form 44, if paid at maturity, bears no interest. It is used when it is desired to have a definite number of notes, each for a fixed amount, the total of the series being equal to the principal and interest of the loan.

It is important that the exact amount of each of these notes should be approved by the accountant before they are signed. The calculations involved are somewhat complicated —as are most calculations involving deferred payments—for the reason that each payment is composed of and reduces both principal and interest, the amount by which *each* is reduced varying with each note; i.e., the portion applicable to principal increases, and the portion representing interest decreases, with each successive payment.

This form of mortgage note is similar to that employed by building and loan societies, most of which draw up tables for their own use showing the amount of principal remaining unpaid at the end of each year or other period. If the note is not paid at maturity, it is usual to provide for the

*Prepared for use in Florida by Frank R. Fleming, Esq., of the Florida Bar.

No. of Coupon........ Jacksonville, Fla., ..., 191

On this ....day of ...., A.D. 191..
without grace, the undersigned promise.. to pay to the order of
....
....
.... Dollars ($............)
in United States gold coin of the present standard of weight and fineness or its equivalent, at ....
for interest due on that day according to the tenor of a principal note of
.... Dollars ($............)
of even date herewith. This coupon bears interest at the rate of Ten (10) per centum per annum from maturity until paid. Value received.

....

Form 43. Mortgage Coupon

.... 191..

.... months after date I promise to pay to the order of .... at .... the sum of $.................... with interest after maturity at the rate of .... per cent per annum.

Value received.

....

This note is secured by mortgage on real estate and is subject to the conditions therein contained.

Form 44. Mortgage Note—Non-Interest Bearing

payment of a penalty, either by naming a fixed sum or by a statement that the note shall bear interest after maturity.

Many forms of mortgage note contain a clause to the following effect: "This note is secured by a mortgage on real estate and is *subject to the conditions therein contained.*"

Attention is called to the words in italics, for such a qualification might seriously affect the negotiability of the instrument—a matter of importance to the accountant, and one which should be considered by the attorney responsible for the drafting of the papers.

While in New York and a few other states it is customary to use a bond instead of a note, it is believed that the note is used in by far the greater part of the United States. In either event the points to be covered are similar, and local usage will determine the form to be used.

§ 118. The Instalment Mortgage

There are certain points peculiar to this form of mortgage which are used as arguments for and against its adoption. Arguments in favor of this form are as follows:

1. The security is in a definite form, and as each payment is made, its value increases in proportion to the amount of the debt.

2. It enables the purchaser to buy on terms as easy as under a contract, and at the same time gives the vendor a security which he can easily hypothecate (or use as collateral for temporary loans, or for more permanent loans, such as debentures, etc.) to greater advantage than a contract.

3. Once the terms are agreed upon, there is no further calculation of interest to be made.

4. Under the laws of most states, the mortgage notes

can be made to bear interest after maturity without rendering the vendor guilty of usury.

The arguments usually urged against this form of mortgage are the following:

1. The vendor receives his principal in instalments and may have difficulty in quickly reinvesting such small sums.

2. The difficulty in determining a fair settlement if the purchaser makes payments in advance, or if he anticipates the payment of the entire amount.

3. The difficulty in arriving at the proper amount of each monthly payment, or if that is fixed, in ascertaining the number of such payments.

The first objection applies equally to all sales where partial payments are made periodically. The answer to it is that such a plan greatly enlarges the number of possible purchasers.

The second and third objections are more formidable in theory than in practice. An elementary knowledge of mathematics will render possible the solution of the two problems involved.

The advantages of this method of sale are so obvious that they need not be enlarged upon. The system should be more generally used. Possibly its lack of popularity has been caused by its similarity to what is usually known as the "building and loan plan," which is much disliked in some quarters. Such prejudice should not receive serious consideration.

§ 119. Annuity Tables

Reference to good annuity tables* will usually solve the questions which arise in connection with instalment mort-

*Stubbins' Annuity Tables will be found advantageous in this connection from the fact that they show monthly payments—something which few, if any, of the other tables do.

gages, i.e.: being given the purchase price and the rate of interest—

1. How many payments of a stated sum are necessary to liquidate principal and interest? Or,
2. The number of payments being agreed upon, what should be the amount of each payment?

As a rule, a concern sells on a fairly uniform basis. For instance, it will accept in payment for sales, say, 120 monthly payments of $11.12 each, for each $1,000 of purchase money with interest at 6% per annum. In such cases a table can easily be constructed showing the division of each payment into principal and interest, so that at any time the amount of principal paid in can be determined.

For example, reference to the table shows that 120 monthly payments of $11.12 will pay off a principal debt of $1,000 with interest at 6% per annum. The interest for the first month on $1,000 is $5, and the principal included in the first payment is therefore: $11.12 — $5.00 = $6.12. The interest for the second month is to be computed on $1,000 — $6.12 = $993.88, and amounts to $4.97; the principal included in the second payment is therefore: $11.12 — $4.97 = $6.15.

The rule for the construction of such tables is as follows: Having found the amount of principal contained in the first payment, multiply this by 1 plus the ratio of interest for one month. At the rate of 6% per annum, the monthly rate would be .005. If the principal part of the first payment is $6.12, the amount of the principal in the second payment will be found by multiplying this amount by 1.005, the same process being repeated until the table is completed.

The amount of principal included in any given number of payments may also be found by reference to annuity

tables or by algebra, these amounts being in geometric progression. The table will appear as follows:

Payment	Amount	Interest	Principal	Principal Unpaid
1	$11.12	$5.00	$6.12	$993.88
2	11.12	4.97	6.15	987.73
3	11.12	4.94	6.18	981.55
4	11.12	4.91	6.21	975.34
5	11.12	4.88	6.24	969.10

§ 120. Change of Ownership

In connection with sales secured by mortgage, one point is sometimes overlooked which is usually covered in contracts—that is, the transfer of the property by the mortgagor, and the consequent change of debtor.

Where concerns handle a large number of purchase money mortgages, much inconvenience is caused by transfers where the mortgage is assumed by a third party without the knowledge of the mortgagee, who is put to unnecessary trouble in finding the person who actually pays the coupons as they fall due. This difficulty can be guarded against by the insertion in the mortgage of a clause obligating the mortgagor to notify the mortgagee of any change of ownership, the wording of such clause depending upon the form of the mortgage itself.

§ 121. Foreclosures

In all business dealings in mortgages, there sometimes arises the necessity of instituting foreclosure proceedings or taking some other steps to acquire the mortgaged property. Occasionally such proceedings require considerable time for their completion, owing to delays in legal processes, to the difficulty in communicating with parties interested, or for various other reasons.

In these cases, it is sometimes wise to transfer such

mortgages from "Mortgages Receivable" to "Mortgages in Settlement," for by so doing the former account will always represent mortgages in good standing. The transfer is made by a journal entry of the following form:

Mortgages in Settlement....................	$......	
To Mortgages Receivable...............		$......
To transfer mortgage No. .... in course of settlement.		

If the value of the property is equal to, or greater than, the principal and interest and charges, these latter should be included in the journal entry; otherwise they should be written off to Profit and Loss.

Occasionally instances occur where the value of the mortgaged property is less than the amount of the mortgage, through an original overestimate or through depreciation from some cause. In such cases, if the settlement is likely to be protracted or, as sometimes happens, it is desired to retain the lien of the mortgage rather than to acquire title, it may be advisable to write off the loss immediately, instead of continuing to show a fictitious asset.*

For example, if a mortgage for $5,000 should fall in arrears and it is decided to foreclose, the value of the property on the best estimates obtainable being only $3,000, the following would be the proper entry:

Mortgages in Settlement........................	$3,000	
Mortgage Deficiency Account....................	2,000	
To Mortgages Receivable..................		$5,000
For mortgage No. ...... in settlement, the estimated value being $3,000.		

The Mortgage Deficiency account is usually written off by a debit entry against Surplus, Reserve, or Profit and Loss, as the occasion may require.

*Some accountants hold that nothing should be charged off to Profit and Loss until sale or settlement has been made.

CHAPTER XVII

TIME SALES—CONTRACTS

§ 122. Simple Form of Contract

The term "contract" is used in this book to cover the great variety of forms of agreement which are given to purchasers, or prospective purchasers, of real estate, and which are known as leases, conditional contracts of sale, bonds for title, agreements, contracts, etc. In this chapter the words "contract," "agreement," and "lease" are all used to describe an agreement providing for sale on the instalment plan.

Perhaps the simplest form of such agreement is one which gives the prospective purchaser the right to occupy certain described lands for a specified time, and also the right to buy those lands during that time at a specified price, provided he makes the required payments. These payments may consist merely of interest at the current rate on the amount of the purchase price, the vendor agreeing that, if all conditions are complied with (including the payment of the purchasing price), he will, at any time during the life of the lease, deliver a deed to the purchaser, conveying good title.

There are many varieties of contracts more elaborate than this, but all of them observe the principle that, upon the conditions specified being carried out by the purchaser, the vendor will convey title to him. The periodic payments may vary to any extent, the usual minimum, as in the case above mentioned, being merely interest on the principal.

§ 123. Conditions Applying to Contracts

The following points affecting the business side of contract sales are of interest to the accountant:

1. It is usual to state clearly when payments are to be made.

2. The purchaser usually agrees to pay all taxes and assessments accruing after a specified date.

3. Restrictions are often imposed as to maintaining present buildings thereon and as to the uses to which they may be put.

4. All buildings are usually kept in repair by the purchaser.

5. The purchaser is usually required to maintain insurance in favor of the vendor, for an amount mentioned in the agreement.

6. The purchaser is prohibited from assigning the contract without the written consent of the vendor.

7. The purchaser agrees not to allow any encumbrance or liens to be placed against the property.

8. It is generally stated that failure to make any required payment when due, subjects the entire agreement to cancellation, either immediately, or after a specified time, such as thirty, sixty, or ninety days.

9. The vendor usually has the right to pay any assessments, etc., which may be overdue, and to charge them to the purchaser or to use them as grounds for cancelling the contract.

10. In event of any legal proceedings being necessary, the agreement is chargeable with all the expenses connected therewith, including court costs, attorney's fees, and, where required, an abstract of title.

11. All payments on account of the contract must be made to the vendor or to some party who is the authorized representative of the vendor.

12. The official address of the purchaser is usually given, and a provision inserted that notice mailed by the vendor to him at that address shall be considered a proper notice of any delinquencies, etc.

13. It is provided that no delay on the part of the vendor in exercising any of his technical rights under the agreement shall be construed to be a waiver of any of his rights thereunder.

14. The agreement is usually executed in duplicate by both parties, each retaining one copy.

In examining such contracts, it is the duty of the accountant to see that the description of the property is correct and in conformity with that shown on the books of account, and that all particulars are properly entered in the contracts ledger.

§ 124. Precision as to Amount of Sale

Another point which calls for care is a definite statement of the total amount of the sale. For example, the agreement may be granted for a nominal consideration of \$100, and may provide that, on the payment of \$1,000 by the purchaser, title will be conveyed to him. These two amounts usually appear in different parts of the agreement, and there is frequently some doubt as to whether the original \$100 is to be included in the \$1,000 or added to it. It is advisable, therefore, that the clause stating the amount of the consideration be clearly stated, as follows:

"The lessor convenants and agrees to and with the lessee that, if the lessee shall, during said term, well and truly pay the rent hereby reserved, including the taxes and other payments for which he is liable, and fully and promptly perform and carry out each and every, the convenants and undertakings on his part, and if, during the term of this lease, the lessee shall have paid the lessor the full sum of ....Dollars, exclusive of the sum named as the consideration of this instrument,

with interest at the rate of .... per cent per annum on the unpaid portion of said purchase price, as hereinbefore provided, then and in that event the lessor shall convey or cause to be conveyed to the lessee a good and sufficient title in fee to the lands herein described."

The consideration for the agreement is, of course, the first payment on the purchase.

§ 125. Pass-Book Contracts

There is one variety of contract which for convenience may be called the "pass-book contract," in which the contract is printed on the first pages of a book similar to a bank pass-book, the description being inserted with a pen, and the agreement duly executed. Following this agreement there are blank pages on which to enter each payment as it is made by the purchaser. This form of book is generally used in handling comparatively small subdivisions, where the general description may be printed in, the only variation being the number of the lot or block covered by each contract.

It is possible that this form of agreement was devised by a banker who had been accustomed to handle savings bank accounts. Theoretically, it has many advantages, for it provides for a complete record of all payments made. In practice, however, it has many disadvantages, for these books are frequently lost, and, still more frequently, the purchasers make payment of an instalment without the book. In many instances the purchasers of some one tract are scattered over the entire United States, and even over the world, and it is then impracticable, of course, to present the book when each payment is made. The value of the book depends upon its containing each and every payment, and confusion is caused by any omissions.

Another method somewhat similar to the pass-book plan

is to draw a lease or agreement in some standard form and make provision on the back thereof for entering payments made by the purchaser, but the objections mentioned above apply equally to this form.

§ 126. Cancellation of Contracts

It is well for the owner of any property to inform himself as to the practice of the courts in regard to the cancelling of contracts. In the case of a time sale secured by *mortgage,* the deed to the purchaser and the mortgage given by him to the vendor are, of course, both recorded, and the agreement can be cancelled only by legal proceedings, or by the purchaser giving to the original vendor—voluntarily or for a consideration—something in the nature of a quitclaim deed to the property. The case may be somewhat different with time sales under *contract.* It frequently happens that such contracts are not acknowledged, and therefore cannot be placed on record; or, in case they are acknowledged and could be recorded, the purchaser may not care to avail himself of this right. In such instances there is nothing on record to show that the sale has been made. In this connection it may be contended that the contract in itself is sufficient evidence of the purchase; yet it is true in many instances that a contract, if properly recorded, is a stronger guarantee than a contract which has not gone through this formality.

The effect of recording varies in different states, and nothing more can be said here beyond the suggestion that those interested should acquaint themselves with the laws prevailing in their particular state.

Probably the original reason for calling such contracts "leases" was the hope that, in case of a delinquent purchaser, resort might be had to something in the nature of a delinquent tenant act, and that the tenant could be evicted

by the simple proceedings applicable to an ordinary tenant who has not paid his rent.

As a general rule, however, the courts have held that under such agreements, when the purchaser has made payments he has acquired an equity of redemption of which he cannot be deprived without legal proceedings similar to those required for the foreclosure of a mortgage. This condition prevails generally, despite the many efforts of able lawyers to draw up an agreement which would enable the owner to regain possession of his property without expense or delay.

In practice this fact is frequently disregarded. In a large number of contract sales, the property sold is unimproved and the purchaser does not take possession of it, does not fence it, or take any other steps to show that he has an interest in it. He may make a few payments at the beginning of the contract and then get tired of the transaction. Very frequently he does not attempt to exercise any rights he may have, and, after a reasonable time, say a few months, the owner may regard the contract as closed without taking any legal proceedings. In many instances he merely notifies the purchaser that the contract will be or has been cancelled, closes out the purchase account on his books, and replaces the lot on his selling list. It is astonishing to discover how frequently this is done and in how few instances any trouble arises to the vendor through such action.

In the process of cancelling a contract through legal proceedings, a condition may arise which, though somewhat peculiar and not infrequently overlooked, has a direct bearing upon the form of contract and the form of the account. It becomes of importance only in instances where the purchaser places every possible obstacle in the way of the owner who endeavors to obtain his rights, and it is

therefore necessary for him to take advantage of every point in his favor. The point is that, time being the essence of such contracts, if a purchaser fail to make his payments as called for by the terms of the contract, the entire principal sum (and not merely those payments which are in arrears) becomes due and payable.

Under such circumstances, it is sometimes wise for the owner to enter suit for the entire purchase price, and by so doing place upon the purchaser the burden of proving each and every payment he has made—thus adding very materially to the difficulty of the defense. In some states such a procedure would not be allowable, and the suit must be brought for the balance of the purchase price, the amount being verified under oath. In any event it is important carefully to consider the exact terms of each contract in which the concern is interested, whether a buying or a selling contract.

§ 127. Comparative Advantages of Mortgages and Contracts

The owners of real estate, particularly of subdivision property, are frequently in doubt as to the best method of selling, and especially as to the relative advantages of selling under mortgages and under contracts, and the legal aspect of this question should be discussed with the owners' attorneys. The best attorneys, however, sometimes fail to realize the practical conditions. The main difference between a mortgage and a contract is that, in the case of a mortgage, the purchaser obligates himself to make certain payments at certain times, and gives his note or notes to that effect. Should he fail to comply with these conditions, proceedings may be brought against him; and if he continues in his failure to make payments, judgment against him will probably be secured. The value of this judgment depends entirely upon the financial standing of the purchaser, and,

in the case of subdivision business, the responsibility of many of the purchasers is so doubtful that a judgment is of little or no value.

On the other hand, under many forms of contract the purchaser is not obligated to continue the payments. In other words, if he fails to comply with the conditions of the contract, he loses what he has put into the property, but the vendor cannot obtain a judgment against him or in any way compel him to pay the balance.

Under these conditions, it is obvious that it is much easier for a sales department to handle a sale of property under contract than under mortgage, although such institutions as trust companies, or others lending moneys on security, have a strong preference for mortgages, based of course upon the personal obligation carried by the mortgage.

§ 128. Contract Statements

The advisability of sending out regular statements of account to purchasers under contracts must be left to the judgment of the vendor. The sending of such statements to those who are in arrears might in some cases tend to weaken the position of the vendor should he desire to cancel the contract. The best practice is to inform each purchaser that he may have a complete statement of his account whenever he asks for it, and to make a memorandum on his ledger account each time such a statement is rendered.

§ 129. Contract Accounts

It will be seen that the general contracts ledger shown in Form 11 (§ 20) provides for one account only for each contract, this account receiving all entries relating to principal, interest, and other charges.

This is more convenient than an attempt to separate the two kinds of entries, as provided for on the mortgages receivable ledger (Form 8, § 18). The reason is that in most cases the contract provides for a minimum payment each month, or other fixed period, and for the calculation of interest periodically. Under such conditions, each payment might be regarded as being composed of principal and interest, as in the case of building and loan mortgages described in § 117.

Such contracts, however, have been construed by some courts to mean, under the above conditions, that the payments made in any six months are to be applied first to the liquidation of the interest calculated at the end of that six months on balance remaining, and then to carry any other charges, such as taxes, etc., the final balance to be applied against the principal. It will be seen that the keeping of an account in such form is complicated and consists of the following steps:

1. Charging the Principal account with principal amount at the time the sale is made.
2. Crediting the Income account with monthly payments.
3. Charging the Income account with charges paid during the six months.
4. Charging the Income account with interest for six months.
5. Closing the Income account every six months; and if the balance is a credit, transferring it to the credit of the Principal account, but if a debit, carrying it forward to the Income account for the next period.

The following example will illustrate these entries where the balance of Income account is a credit:

			Principal Dr.	Principal Cr.	Income Dr.	Income Cr.
Jan.	1	Principal	$1,000.00	......	......	......
Feb.	1	Cash	....	......	......	$20.00
Mar.	1	"	....	......	......	20.00
Apr.	1	"	....	......	......	20.00
"	10	Insurance Paid	....	......	$45.00	......
May	1	Cash	....	......	......	20.00
June	1	"	....	......	......	20.00
"	30	"	....	......	......	20.00
		Interest	....	......	27.90	......
"	30	Balance of Income account transferred to Principal account	....	$47.10	47.10	......
					$120.00	$120.00

Such details greatly add to the labor of bookkeeping where a large number of accounts are involved, and, as a matter of fact, in practice the purchaser usually wishes to know merely the *total* balance remaining unpaid.

Let it be assumed that the above *pro forma* account complies with strict legal requirements, and is such as would be called for in the event of legal proceedings being brought to cancel the contract. But such contracts are made for the purpose of effecting sales, and not for the promotion of litigation; and the number of contracts taken to court forms a very small proportion of the number issued. Under these circumstances, it is best to keep the entire account as provided in the general contracts ledger of Form 11 (§ 20), and, when litigation ensues, to make up the account in the second and more detailed manner.

Little attention need be given to the argument that, under such practice, the account as rendered in court would differ from the ledger account, for the reason that the ledger is not a book of original entry, but merely a convenient

method of collecting and arranging entries originating in other books. In such a case the contract itself would form the basis of any argument, and the cash book would show all receipts thereon.

The general subject of interest on contracts is discussed in Chapter XIX.

CHAPTER XVIII

OPTIONS

§ 130. Nature of an Option

An option, as understood in connection with real estate, is an agreement which conveys the exclusive right to purchase a definite piece of property for a stipulated price within a specified time. In other words, the term "option" is used to "express the privilege given to conclude a bargain at some future time at a price agreed upon."

THE ALPHA LAND COMPANY
NOCATEE, GEORGIA

Option No.......... ....191..
Received of...
The sum of...Dollars
FOR AN OPTION for 30 days at $.................................
on ....
....
....

At expiration of this option it can be renewed for 30 days upon payment of $.............., and so on, month by month. It is understood that you acquire no interest in the property until the option payments shall aggregate the sum of $.............., and this option is forfeited should you fail to renew it month by month as herein provided. When a total of $.............. has been so paid, THE ALPHA LAND COMPANY will give a lease to the property; and when you have complied with all the terms of said lease, it will give a deed conveying all its right, title and interest in and to the lot... hereinabove described.

THE ALPHA LAND COMPANY,

$............. B..........................

(This receipt made in duplicate)

Form 45. Option

NOTE: When required, provisions as to roadways, building restrictions, etc., may be included in the option.

Options were originally employed in cases where the purchaser desired time in which to raise the purchase money, to complete an investigation, to confer with partners, or for some similar reason. Of late years, however, they have been used in some instances by the owners of subdivision properties as a preliminary to a regular contract. The plan is useful where the purchaser does not wish to make the full first payment required for a contract, and the vendor does not desire to draw up regular papers until such payment is made.

If this plan is applied to a rent-producing house which the holder of the option is allowed to occupy during the life of his option, care must be taken to see that the rent is properly treated in the accounts. If the rights under the option are exercised, the rent, under the usual arrangement, will form a part of the purchase price. If the option is allowed to lapse, the monthly payments remain as *rent*. In such cases, the simplest plan is to enter these receipts as rent, and, when a contract is given, to transfer the total of such payments from Rent account to Contracts account. Form 45 is a typical form of option and is self-explanatory.

§ 131. Accounting Treatment of Options

The bookkeeping entries, save as to rent-producing properties, should credit "Options" with option payments as they are received; and if the number of such transactions warrants it, a sub-ledger should be opened for individual accounts of option holders. The commission ledger (Form 12, § 21) provides for agents' commissions in such cases.

In the event of an option being allowed to lapse, the amounts paid in should be credited direct to Profits account; and in the event of an option being exercised, the consideration therefor having been paid, the amount so paid is transferred to the credit of Real Estate, Contracts, or

other appropriate account. In no case does any liability attach to the purchaser, but the vendor obligates himself to give title, or some form of guaranty for title, upon the conditions being fulfilled.

§ 132. Refusals

An option differs in the last point above mentioned from what is generally known as a "refusal." This may be described as a promise made by the owner to give the holder the first choice on a certain property; a promise that the owner will not dispose of the property to another party until the holder of the refusal has been notified. This latter is usually allowed a short time after notice, say twenty-four hours, in which to close or relinquish the bargain. Refusals are usually given without any consideration, for the paper carries with it but a slight obligation, and in practice it is found that the existence of a refusal often stimulates other purchasers. If any consideration does pass, it is entered on the books as in the case of options.

§ 133. Deeds in Escrow

Signing, sealing, and delivery are all essential to a deed. It is sometimes desired that delivery be not made until some future date, or until certain conditions have been performed. In such cases the deed is placed *in escrow;* that is, it is handed over to a third party to be held by him until the requirements are fulfilled, and these are usually committed to writing and deposited with the deed.

In such cases all entries, except those showing receipt of the consideration, are made in the records as if the transaction were consummated, for all papers have been executed; but a notation giving the particulars of the escrow is made on the real estate ledger. If the escrow is broken, such entries are cancelled. If it is carried out, the consideration is then entered on the books.

CHAPTER XIX

INTEREST

§ 134. Mortgage Interest

Mortgage interest is that accruing upon the unpaid portions of the purchase money represented by notes secured by mortgages or provided for in a contract. The simplest form in which interest on mortgages appears is shown in the mortgage coupon of Form 43 (§ 117).

In connection with interest on mortgage notes, two separate and distinct facts must be noted: first, that the interest becomes due at a fixed time, and second, that this interest is paid to the holder of the mortgage. Revenue account is therefore entitled to be credited when the interest falls due, but the mortgagor is not credited until he makes the payment, and it is a well-known fact that interest on mortgages is not always paid promptly.

In order to record these two phases of the transaction, it is necessary to open in the general ledger two accounts which may be designated as follows:

1. Mortgage Interest Receivable
2. Overdue Mortgage Interest Receivable

All interest as it accrues, i.e., as it becomes fully earned, is credited to the first, and debited to the second, of these accounts; and when that interest is paid, it is credited from the cash book to the second account.

A method for recording such items is described in § 47. In practice, such entries may be made at the beginning of each month in the following form:

Overdue Mortgage Interest Receivable..............		$245	
To Mortgage Interest Receivable.............			$245
For interest falling due in the month of ...., as follows:			
Mortgage 82, Jones, due Jan. 10.......	$50		
" 97, Smith, " " 15.......	75		
" 105, Robinson, " " 30.......	120		
	$245		

The account "Mortgage Interest Receivable" is thus composed entirely of credit items, the total amount being carried to Profit and Loss upon the closing of the books (§§ 212, 213).

As will be seen, this account is an income account showing the total interest of this class earned. It is therefore a matter of importance to see that a proper record is kept of all such interest coming due, and for this purpose a mortgage interest register similar to Form 39 (§ 47) is provided. In this record each mortgage should be entered as it is received and the interest be entered in the proper columns to indicate the months in which it falls due. On the first of each month, the record is examined to see that the last mortgages received are entered; the items appearing to accrue during the ensuing month are checked to prove their correctness, and to determine whether or not all payments of, or reductions in, principal have been allowed when calculating the interest due. The column is then added, and the total forms the basis of the journal entry shown above.

The Overdue Mortgage Interest Receivable account contains debit entries corresponding to the above-mentioned credits, and credit entries showing all interest actually paid, the balance being the interest accrued but unpaid, which appears in the balance sheet as an asset. However, it is held

by some accountants, that wherever a balance sheet and a profit and loss statement are made up, all interest accrued should be computed and placed on the books.

§ 135. Interest Adjustments

It frequently happens that interest on mortgages, already charged, is either reduced or cancelled, and in such cases debit items are brought into the Mortgage Interest Receivable account by the following entry:

Mortgage Interest Receivable................	$......	
To Overdue Mortgage Interest Receivable		$......
To cancel (or reduce) interest charged on mortgage No. .... $............		

As explained in § 18, all entries made in the general ledger to the Overdue Mortgage Interest Receivable account should also be posted to the sub-ledgers.

A slight variation from the form of note and coupon in Forms 42, 43 (§ 117) must be made when the principal is divided into a number of equal parts due at equal intervals, each part being represented by a note in which there is included interest computed to the date of that note.

For example, a mortgage is given to secure $3,000, payable in three equal instalments due at intervals of one year, bearing interest at the rate of 6% per annum. The notes—maturing, respectively, one, two, and three years from date—are as follows:

$1,000 +	interest	on	$3,000	for	1	year	= $1,180
1,000 +	"	"	2,000	"	1	"	= 1,120
1,000 +	"	"	1,000	"	1	"	= 1,060
							$3,360

The foregoing indicates the method of entering such notes, care being taken to set forth the fact that $3,000 is principal and $360 is interest.

§ 136. Unearned Interest

We now come to the second class of mortgage interest, where interest on the entire mortgage is calculated at the beginning, added to the principal, and the sum divided into a number of equal parts. This method is similar to that frequently used by building and loan associations. It is important to ascertain the exact amount of each of the items, principal and interest, which compose the total amount represented by the notes. The various methods of doing this will be considered later. The general form of entry is as follows:

Mortgages Receivable........................	$......	
To Real Estate........................		$......
" Unearned Interest..................		......

It will be seen that Mortgages Receivable account is debited with the total of principal and interest, for the reason that these are represented by definite notes, or sometimes by an obligation to make a specified number of payments, the actual execution of the notes being dispensed with on account of the labor involved, in which case the text of the mortgage is changed to correspond.

The discussion in Chapter XX of real estate profits actually earned, emphasizes the importance of keeping each class of transaction distinct. With this in view, it is advisable to place by itself all such interest as that now being dealt with, and to keep it distinct and in a separate account from ordinary Mortgage Interest and from Interest and Discount. The name "Unearned Interest" is suggested for this account as being both appropriate and explanatory.

§ 137. Unearned Interest—Methods of Calculating

There are three methods of calculating this "unearned" interest:

1. By a rough averaging of the time, i.e., the life, of the mortgage.
2. By reference to tables.
3. By mathematical calculation.

The first is a rough-and-ready plan which is frequently adopted but which is not accurate. It is based upon an average of the interest, and, instead of charging interest at the nominal rate for the entire period, it is charged at that rate for one-half the period, and this amount is added to the principal. The sum is then divided by the number of payments to be made.

For example, what would be the amount of each monthly payment in order to pay off $1,000 in ten years, interest at 6%?

The simple interest for half the period, i.e., 5 years at 6% per annum = 30% of the principal; the number of payments is 120.

$$30\% \text{ of } \$1{,}000 = \$300$$

$$\frac{\$1{,}000 + \$300}{120} = \$10.833, \text{ the monthly payment}$$

For the second method, there are published numerous tables showing present values of annuities, and most of the problems occurring in practice may be solved by their use. As rules are always attached to each set of such tables, showing the manner of using them, this need not be discussed here. Most tables in use, however, are based on quarterly, half-yearly, or annual payments, and it is frequently necessary to base calculations upon monthly pay-

ments, in which case special tables must be used.* Before tables can be used we must know whether the interest is to be charged half-yearly or monthly, and if the latter, whether each monthly payment is to be made on the first or the last day of each month.

The third method of determining the monthly payments by mathematical calculation involves the use of complicated formulae, and sometimes logarithms — matters beyond the scope of the present work. The results obtained coincide with those given by any reliable tables; but by means of formulae it is, of course, possible to answer any question which may arise, whereas the tables can only be used for those questions in which occur certain definite periods.

Taking the example just given, the tables or the mathematical calculations give us the following results:

1. If interest be reckoned on half-yearly balances, ignoring the fact that a payment has been made each month........................	\$11.23
2. If each payment be made on the last of the month, and interest be allowed thereon....	11.12
3. If payments be made on the first of each month, and interest be allowed thereon..........	11.01

It will be seen that, by using different methods the results may vary as much as 39 cents on each payment (i.e., \$11.23 — \$10.84), or a total of \$46.80 on the principal. If real estate dealers realized more fully the existence and amount of these differences, they would undoubtedly take the necessary trouble to have accurate calculations made. As a matter of fact, under the first method, the seller does not receive the percentage which he thinks he is getting, i.e., 6% in the instance given.

*See Stubbins' "Tables of Present Value of Annuities," an English work.

§ 138. Unearned Interest—Alternative Methods of Calculating

While the method of calculating interest above outlined is correct, it is extremely inconvenient in an office where there are many contracts involving such interest calculations, and various attempts have been made to simplify matters. One plan consists in calculating the interest half-yearly on fixed dates, these dates being the same in all contracts of one class. This reduces the work of the bookkeeper, inasmuch as it brings all such interest calculations at two stated times each year instead of scattering them through every month of the year.

Another plan which has been adopted with some success is to calculate the interest every six months on the balance then unpaid. This is convenient for the bookkeeper, as it enables him to take his monthly trial balance and simply calculate the interest on each amount shown thereon. An example of such a calculation is given in § 139.

The effect of this method of calculating the interest is far-reaching — more so than would appear at first sight. For instance, if a purchaser made a substantial payment on the last day of the half year, he would, under the above arrangement, save half a year's interest on that payment; and the result to the vendor is that, instead of realizing an 8% interest, he realizes perhaps 7½%. There is still another aspect to be considered. If a purchaser does not make any payments for a year or two, and interest is added on the outstanding balance each half year, he is, of course, being charged compound interest, which is illegal in many states.

A third method, which yields results sufficiently accurate for all practical purposes, assuming that payments are made regularly, is to calculate the interest, say, April 1 and October 1 of each year, on the balances remaining

unpaid at the middle of the half-year (in this case, on January 1 and July 1). This is definite, simple, and accurate, and might well be generally adopted.

In any event, it is economical and convenient to arrange for all interest to fall due at fixed periods in the manner indicated, and it also tends greatly toward correctness.

§ 139. Unearned Interest—Various Examples

In order to compare the results obtained by the different methods of calculating interest, let us take the example of a contract for $5,000 dated January 1 and payable in monthly instalments of $100 each, interest being charged each half-year at the rate of 6% per annum on the balances remaining unpaid from time to time. Let us suppose the $100 is paid on each of the following dates:

January 30	May 20	September 15
February 15	June 30	October 10
March 15	July 30	November 20
April 10	August 15	December 31

If interest is calculated when each payment is made, the figures will be as follows:

Jan. 1	Principal		$5,000.00
June 30	Deduct six payments		600.00
			$4,400.00
	Add interest on $5,000	$150.00	
	Less interest on $100 for:		
	5 mos. 0 days (Jan. 30 to June 30)		
	4 " 15 " Feb. 15 " " "		
	3 " 15 " Mar. 15 " " "		
	2 " 20 " Apr. 10 " " "		
	1 " 10 " May 20 " " "		
	17 mos.	8.50	141.50
			$4,541.50
Dec. 31	Deduct six payments		600.00
			$3,941.50

Add interest:			
For six months on $4,541.50 at 6%...		$136.24	
Less interest on payments as above.		8.50	127.74
Balance at end of year..................			$3,813.76

If the interest is calculated on the balances remaining unpaid at the end of each half-year, the result will be:

Jan. 1	Principal due..............................	$5,000.00
June 30	Deduct six payments..........................	600.00
		$4,400.00
	Add interest for six months on $4,400 at 6%....	132.00
		$4,532.00
Dec. 31	Deduct six payments..........................	600.00
		$3,932.00
	Add interest for six months on $3,932 at 6%...	117.96
	Balance at end of the year.................	$4,049.96

If no payments are made, the figures would be:

Jan. 1	Principal....................................	$5,000.00
June 30	Interest for six months......................	150.00
		$5,150.00
Dec. 31	Interest for six months.......................	154.50
	Balance at end of the year.................	$5,304.50

Here the interest is compounded, which, under the laws of some states, is illegal. In such cases, the proper calculation, figuring simple interest, would be as follows:

Jan. 1	Principal....................................	$5,000.00
June 30	Interest for six months.......................	150.00
Dec. 31	Interest for six months.......................	150.00
	Balance at end of the year.................	$5,300.00

If interest is charged on the "average balances," the figures would be as follows:

Jan. 1	Principal	$5,000.00
June 30	Deduct six payments	600.00
		$4,400.00
	Add interest on balance of March 31, viz.: $4,700	141.00
		$4,541.00
Dec. 31	Deduct six payments	600.00
		$3,941.00
	Add interest on balance of September 30, viz.: $4,241	127.23
	Balance at end of the year	$4,068.23

It must be remembered that, in all the examples, the differences will rapidly increase as time progresses.

§ 140. Unearned Interest—Phraseology of Interest Clause

It is most important to express definitely and clearly the method of calculating interest on unpaid balances, but many forms of contract are ambiguous in this respect. For instance, they usually contain a clause similar to the following: "with interest at the rate of......per cent per annum on the unpaid portion of said purchase money." It is also common to specify whether this interest shall be calculated quarterly, half-yearly, or on certain specified dates.

The uncertainty is due to the use of the expression "unpaid portion of said purchase money," the exact interpretation of which probably depends upon the laws of the locality in which the contract is executed. In many states it will be interpreted to mean that, estimating on half-yearly periods, a calculation must be made at the time of each payment. In other words, when the purchaser makes

a payment, the vendor must calculate the interest to that date, add this to the existing principal, and credit the payment made.

It is believed that under most of the existing laws the ambiguity of contracts in regard to interest could be removed by the following phrasing: "Interest shall be calculated half-yearly on the first day of......and the first day of......upon the balances remaining unpaid," or "Interest shall be payable half-yearly on the first day of...... and the first day of......and on being so calculated shall be added to the principal." The exact wording of this modifying phrase must be left to the attorney of the concern, for it will depend not only upon the wishes of the vendor, but also upon the laws under which he is living.

§ 141. Unearned Interest—Journal Entries

The form of mortgage under discussion necessitates a form of journal entry that will meet special conditions, inasmuch as it should show the principal and all the interest, both being included in the amount of the mortgage. This interest, however, is not yet earned, and will not be earned in full until the final payment is made on the mortgage. Under these circumstances it is plainly improper to carry this interest into Mortgage Receivable Interest account, which is periodically closed out into Profit and Loss account. It must be carried separately in an account which may be called Unearned Interest account.

For example, a purchaser buys from a vendor for $1,000 a piece of property which is to be paid for in 120 monthly payments, interest being at 6% per annum, calculated half-yearly. As was shown in § 137, the amount of each of these notes should be $11.23, and the 120 notes would aggregate $1,347.60. Omitting all entries regarding profit on the transaction (which have already been described in

Chapter XIII), the journal entry would have the following form:

Mortgages Receivable......................	$1,347.60	
To Property Account................		$1,000.00
" Unearned Interest................		347.60

§ 142. Interest Accrued Not Due

When preparing a balance sheet and other accompanying statements, it is frequently proper to show thereon items for interest accrued but not due, in order to arrive at the actual condition of the business on the date of the balance sheet. This accrued interest is the amount which has accrued on each item since the last entry of overdue interest.

While the amount should be calculated accurately, and not merely estimated, it is not always advisable to enter it on the books, as any such entry may lead to complications in the following year, for the reason that the numerous items of accrued interest fall due at different periods and it is necessary to determine each month (for possibly the eleven months following the balance sheet) the amount which has become due, and this amount is to be credited to interest accrued instead of to interest overdue.

This is one reason why many real estate concerns have found it best *not* to take into the balance sheet interest accrued but not due. The consequent inaccuracies are reduced in amount if interest is made payable quarterly, and also if the last day of the fiscal year be selected as one of the regular dates for calculating interest, as suggested in § 138.

CHAPTER XX

EARNED PROFITS AND BOOK PROFITS

§ 143. Book Profits

So far, the consideration of profits from sale of real property has been confined to the methods of bringing them on the books of account. The present chapter will consider how much of these "book profits" has been actually earned and therefore may be distributed to the stockholders as dividends. It is proposed to discuss this question in detail, but only so far as it relates to gross profits, that is, to the difference between the cost of the property and its selling price.

If the methods described in the preceding chapters have been followed, the profits will appear in the general ledger in one or more accounts, each of which is distinguished by the word "Gain" appearing in the name of the account, as "Gain on Sales," "Hillbrook Gains," etc. The profits remain in these accounts until it is desired to close the accounts and ascertain the profits for any given period. The only exception to this rule is in the case of cash sales, where the gains are carried directly to "Profits" (§ 82), and of those time sales which have been cancelled and the gains carried to "Cancellation Profits" (§ 153).

§ 144. Gains Distinguished from Earned Profits

The distinction between gains and earned profit can be made clearer by the use of a concrete example, which will also afford a comparison of the various methods of dealing with profits. Assume that a corporation has acquired a

tract of land at a total cost of $60,000, and that by means of advertising, exploiting, development, and a general enhancement of values, it has been able to sell this tract for $180,000, thus gaining $120,000. If the sale were made for cash, the following entries would appear on the debit side of the cash book:

Real Estate...............	$60,000
Profits.................	120,000

At the closing of the books, the Profits account is credited directly to the Profit and Loss account, the balance of which account may then be available for the payment of dividends.

Suppose that the transaction is a time sale, that a nominal cash consideration is inserted in the deed of conveyance, and that payment is to be made in five instalments as follows:

No.	Amount
1	$24,000
2	30,000
3	36,000
4	42,000
5	48,000
	$180,000

Any considerations regarding interest are omitted here, as this subject has been treated in Chapter XIX.

It is obviously improper to carry to the Profit and Loss account the entire profit of $120,000 when the first instalment is paid, as only 24/180 of the entire price has been paid in. If this were done, the entire profit of $120,000 might be paid out in dividends or be declared payable as such, while, as a matter of fact, the other four instalments might not be paid at all and the vendor be obliged to take

back the property. In such case—which is not unknown—the transaction would stand on the books as follows:

Original cost................	$60,000	
Dividends declared...........	120,000	$180,000
Less first instalment.................		24,000
Balance remaining unpaid..........		$156,000

If the sale was not carried out, the unearned profit, having been used for the payment of dividends, must be written off to something. The only practicable disposition is to charge it to the cost of property, or to charge it back to Profit and Loss in the next statement. The latter is the better plan, as the former would involve the inflation of Real Estate account by $96,000.

It may be argued that the purchaser could be forced to make good any losses incurred through his failure to complete his purchase. This may or may not be true, depending, first, upon the nature of the agreement under which the sale was made, and second, upon the ability of the purchaser to pay. If the property were sold on some form of contract, there might be no obligation on the part of the purchaser to pay the entire price. If the unpaid portion of the price were secured by mortgage, recourse to the courts might result in a judgment the value of which would depend entirely upon the resources of the mortgagor. But aside from such contingencies, it must be noted that in dealing with real estate securities the common practice, and the safe and proper one, is to depend on the value of the physical security and not upon the financial standing of a mortgagor. Therein lies the safety of such securities, and therein is also found the favor with which mortgages are regarded by conservative investors. When a real estate

corporation departs from this principle in its transactions, it justly forfeits the confidence of the public.

§ 145. Rule for Calculating Earned Profits

Admitting that all the profit is not earned until all the payments are made, it follows that the profits *are earned in proportion as the payments are made.* In other words, the earned profit bears the same ratio to the total book profit as the payments made bear to the total selling price.

In our example, therefore, the profits would be earned as follows:

No.	Instalments	Corresponding Earned Profits
1	$24,000	$16,000
2	30,000	20,000
3	36,000	24,000
4	42,000	28,000
5	48,000	32,000
	$180,000	$120,000

The rule for calculating the earned profits may be formulated in the following manner:

$$\frac{\text{Payments made}}{\text{Total selling price}} \times \text{total gain} = \text{earned profits}$$

It is evident that the total profits divided by the total selling price gives the ratio of profit to be deducted from each instalment payment as actually earned profit; e.g., when the above transaction is completed, the total profit thereon is $120,000, which, divided by the total selling price, $180,000, shows the ratio of profit to be 66⅔%. Therefore, on the first payment of $24,000, the earned or realized profit would be 66⅔% of this sum, or $16,000.

It may be argued that the course indicated is too con-

servative, and that, when a considerable portion of the price has been paid, say one-half, it is safe to assume that all profits accruing from the transaction are already earned—on the ground that the security is worth double the amount of the unpaid purchase money. In the case of a sale under contract, this assumption is not justified, on account of the absence of any obligation on the part of the purchaser to pay the full amount. In the case of a mortgage, it is admitted that, in certain instances, it may be safe so to regard the matter; for instance, in the case of a dwelling, office building, or other property available for a large variety of purchasers or users, on which half of a reasonable purchase price has been paid. Such conditions, however, are frequently absent from large transactions, where the actual considerations may be based on possible profits to be derived by a purchaser, as in the case of a development company; or where the transaction is of such magnitude, or the property concerned of such a nature, that the number of possible purchasers or users is materially restricted.

§ 146. Anticipation of Earned Profits

In order to show the possible dangers arising from regarding as earned all the profits resulting from a sale when only a part (say one-half) of the selling price has actually been paid in, the example already given may be taken. In this, on the completion of the third payment one-half of the price has been paid. If no further payments should be made, there would remain unpaid $90,000, of which $60,000 would be unearned profits. These profits, it is assumed, have been anticipated and, together with the $60,000 actually earned, have been carried to the Profit and Loss account. The transaction being cancelled, it is necessary to write off the unpaid balance, which will ordinarily be to the Real Estate account, as already suggested; and the property which was

purchased originally for $60,000 now stands on the books at a valuation of $90,000. If this operation were repeated several times, it becomes evident that the book value of the property would equal or exceed the selling price of $180,000. Further, if such a course were followed, it is obvious that, through a series of dummy sales, a fraudulent management could inflate to any amount the book valuation of the real estate holdings.

Other reasons, also, commend the practice of making earned profit dependent upon, and in proportion to, the part of the selling price actually paid in. It is not so much the duty of directors to pay out as dividends every cent as soon as it is apparently earned, as it is to safeguard the credit and stability of the company which they serve; and this is most effectively accomplished by creating a reserve for the protection of the future; this reserve will also serve to maintain the market value of the capital stock. Prudent management, a strong reserve, and a conservative method of handling profits go much further toward winning and retaining public confidence than the occasional payment of large dividends.

Moreover, as has been seen in the case of time sales under contracts, it is manifestly improper to consider all the profits as earned before the transaction is closed. It is very desirable to treat uniformly as to profits, accounts which are so similar as the two classes of time sales known as "mortgages" and "contracts."

§ 147. Equity as a Basis for the Calculation of Profits

The following case occurred in actual practice, and is given here because it illustrates an apparent divergence from the rules suggested.

John Doe owned a house which cost him $8,000, and on which there was a mortgage of $4,500, thus leaving him

an equity of $3,500. He sold the house to Richard Roe for $9,000, of which $3,000 was payable in cash. The existing first mortgage of $4,500 was assumed, and a second mortgage for $1,500, payable in one year, was accepted by Doe.

In this case, it is not the total price of $9,000 which would form a basis for calculation, but rather the price obtained for the equity of John Doe, viz., $4,500. Of this equity, $3,000 being paid in cash, two-thirds of the profit of $1,000 would be realized immediately, and the remaining one-third would be realized upon the payment of the second mortgage of $1,500.

CHAPTER XXI

CANCELLATIONS OF TIME SALES

§ 148. Time Sales and Cancellations

In every business where payments are made on an instalment plan, it is inevitable that there should be a certain number of lapses; and the real estate business is no exception to this rule. If such a business is properly conducted and the accounts carefully watched, these lapses should result in profits to the concern, although these profits will evidently be less than if the sales had been completed. Indirect or subsequent profits arising out of the resale of the property involved are, of course, treated as new business. In other words, each cancellation profit leads to an immediate reduction of the "Gain on Sales" (the reserve profits), and to an immediate but smaller addition to the earned profits.

§ 149. Amount of First Payment

The amount of the first payment, except in special cases, such as unimproved, suburban, and subdivision properties, should usually be a fixed percentage of the purchase price, and sufficient to cover several monthly instalments. No uniform rule as to its amount can be laid down, but several large concerns doing business in the Southern States require 10% of the purchase price to be paid in before contracts will be executed. The rule is based on the belief that, if a purchaser cannot now, or in the immediate future, pay this 10%, he probably will be unable to meet regularly the future payments. The system has yielded excellent results, and has led to the use of options, such as shown in § 130, which

are available when a desirable purchaser requires a little time in which to make the first payment.

§ 150. Payments in Arrears

It is even more difficult to give any general rule regulating the amount of time to be allowed delinquents. No banker would arbitrarily decide that all his loans and discounts should receive 90 days' extension and no more. Illness or loss of work may cause a good customer to fall in arrears for a time; or a purchaser may spend money in improvements on the property, which would otherwise have been applied on the periodic instalments. Each case must be carefully considered on its merits, for in deciding such questions, not only the value of any particular piece of property must be considered, but also the reputation of the purchaser.

On the one hand, arrears should not be allowed to accumulate to such an extent that a surrender of the property would result in loss; on the other hand, it is unwise for a concern to avail itself of every technicality in order to foreclose at the earliest date legally possible, for such a reputation is thereby earned as will tend to drive away prospective customers.

To a concern selling on the instalment plan, a reputation for generous dealing is a valuable asset. It should be remembered that, even if arrears are allowed to run for a time after a considerable number of payments have been made, interest also is usually running, and though there will be a reduction in present cash receipts, the final profits will in no way suffer.

In cases where arrears have accrued and doubt exists as to the final disposition of the contract, it is good policy to omit the calculation of interest while this condition continues. This avoids the creation of a possibly fictitious asset,

for when interest is included in these contract accounts, it becomes technically an asset and increases the amount of "Contracts" on the balance sheet. Should normal payments be resumed, it is a simple matter to add all interest so omitted.

§ 151. Accounting Treatment of Cancellations

Let us assume that it is desired to cancel a contract, the original amount of which was $3,600, $900 being profit and the payments amounting in all to $400; i.e., the original amount of $3,600 has been reduced by $400 after debiting interest and all charges. For the sake of simplicity, this reduction in balance is regarded as the amount paid in, as in practice, of course, it is only the reduction on the debt which affects the profits earned.

The original profit would be credited to Gain on Sales account, and reference to the annual analytical sheets of that account (§ 269), or to the sub-ledger if similar to that of Form 15 (§ 23), will show that at the closing of the books $80 of profit had been earned and $820 remained in the Gain account. Three figures have then been determined, viz.:

1. Cost of the property, $3,600 — $900 = $2,700.
2. Balance remaining in Gain account, $900 — $80 = $820.
3. Balance due on the contract, $3,200.

And there is still to be determined—

4. Cancellation profits.

It is required to debit Real Estate with the property reacquired, and Gain on Sales with the amount remaining therein; and to credit Contracts with the balance to be extinguished, and Cancellation Profits with the earned profit not yet written off to Profit and Loss account.

Since the debits are \$3,520 (\$2,700 + \$820), and the credit is \$3,200, the remaining credit must be \$320. The journal entry, therefore, is as follows:

Property Account..............................	\$2,700	
Gain on Sales..................................	820	
To Contracts............................		\$3,200
" Cancellation Profits..................		320
To cancel contract No..........		

By means of these entries, the Gain on Sales account is kept "clean" and all amounts relating to this transaction are eliminated. This is a matter of importance, especially in the case of subdivision contracts. (See § 181.)

§ 152. Erroneous Cancellation Entries

This matter is discussed in some detail for the reason that many bookkeepers make incorrect entries when closing out contract accounts, usually reasoning as follows:

The contract balance is \$3,200, the property is worth \$2,700, and the original gain was \$900; therefore the entry is the following:

Real Estate....................................	\$2,700	
Gain on Sales..................................	900	
To Contracts............................		\$3,200
" Profits................................		400

The fact that a part of this profit has already been carried to Profit and Loss is overlooked.

Another erroneous form is as follows:

Real Estate....................................	\$2,700	
Gain on Sales (Originally \$900)		
(Cash paid in 400)..............	500	
To Contracts............................		\$3,200

In each of these cases, it will be seen that an amount is left in Gain on Sales account which is unaccounted for; in the first instance, \$80, and in the second, \$320 (i.e., \$900 — \$80 — \$500).

§ 153. Cancellation Profits Account

It will be seen that the correct entry calls for a new account, "Cancellation Profits," which is intended to receive the forfeited profits from all classes of time sales which may be cancelled during the year. It is extremely useful to have such an account, showing at a glance all cancellations, for the total of these should always be found at each closing of the books and be included in a schedule, in order that the management may have accurate information as to the ratio of such cancellations to the gross sales. In entering items to this account in the ledger, it is convenient to make additional memorandum entries showing the total amount of the sales affected by the cancellation profits, in some such way as the following:

CANCELLATION PROFITS

(Credit side of ledger account)

		Total Cancelled	Profits	Monthly Totals
1917				
Jan. 10	Contracts (general)..........	\$4,200.00	\$800.00	
20	Kingslake	2,200.00	750.00	\$1,550.00
Feb. 20	Ladore	1,200.00	240.00	

From the above figures, it is easy at any time to make an analysis showing the various classes of sales which have been cancelled and the total amount of each.

The principles here laid down for the treatment of contracts apply equally to mortgages. Care should be taken

to consider *the reduction of the principal debt;* and any charges standing in the Income account should be balanced by charging them to the appropriate nominal account, viz., Mortgage Interest Receivable, Taxes, Insurance, etc.

The above remarks apply to general contracts, the details of subdivision properties being considered in the next chapter. For the sake of convenience, however, the cancellation of subdivision time sales is discussed here.

§ 154. Cancellation of Subdivision Sales

In the case of subdivision sales, the same principles apply, but the data is secured in a different manner.

Take for example a lot in Eureka Gardens subdivision sold for $240, yielding a profit of $120. Assume that $30 was paid in cash, of which $15 was carried to Profit at the last closing of the books. It is now desired to cancel this contract, and the journal entry will consist of four items, viz.:

Eureka Gardens Purchase...........................	$120	
Eureka Gardens Gains..............................	105	
To Eureka Gardens Contracts.................		$210
" Cancellation Profits.......................		15

In explanation of this entry, it may be said that the cost of a Eureka Gardens lot and the balance of the contract are fixed amounts, viz., $120 and $210 respectively. The subdivision ledger shows that $15 has been carried to Profit and Loss account, leaving $15 for Cancellation Profits. The total of the fixed credit entries is therefore $225, and the remaining debit entry must therefore be $105.

The same result may be approximately arrived at by ascertaining the ratio between the collections and the selling price at the time the books were last closed, and assuming that the corresponding percentage of total credits up to

the end of the last fiscal period has already been carried into Profit and Loss. If this amount is deducted from the same percentage of the total cash received, the difference will be the amount now to be carried to Cancellation Profits.

It is, of course, evident that, if we were to carry to Cancellation Profits the entire amount paid in, we should be carrying far too much and be anticipating profits, as would appear from the final payments when the whole subdivision was sold out and paid for.

CHAPTER XXII

SUBDIVISION, DEVELOPMENT, AND SUBURBAN PROPERTIES

§ 155. Acquirement

While subdivision properties may be acquired in the usual manner by a deed of conveyance paid for by cash or by a mortgage payable, the method employed sometimes is quite different. The concern selling on contract may itself be buying under a contract, or it may have merely a selling contract, the title remaining in the owner and the concern acting as an agent. Examples of these methods are shown in detail in §§ 200, 204, 232, and 250.

§ 156. Release of Lots from Encumbrances

When the concern does not own an unencumbered title, it is usual to make some definite arrangement under which the owner agrees to convey, or the mortgagee to release, such lots as are paid for in full by the customers of the concern. Otherwise, it might be necessary for a purchaser to await the completion of the concern's contract, or the payment in full of its mortgages, before he could receive an unencumbered title.

The terms under which such deeds to lots are issued vary greatly. Sometimes the deed is given only when the proportion of the purchase price applicable to that lot is paid to the owner in full, such amounts being, of course, credited to the concern and deducted from the total amount to be paid by it for the entire tract. Sometimes the owner or the mortgagee agrees to convey or release a part of the land

proportionate to the payments made. In the case of selling contracts, the owner usually requires that he shall receive the full price for any specific lot he is required to deed during the active life of the contract. Whatever the terms and conditions may be, it is important that the accountant inform himself of them from the original agreement or from a complete copy thereof, in order to open appropriate accounts and make all proper entries.

§ 157. Cost Price of Property

Other points of importance are the ascertainment of the cost price and the making of some definite provision for changes in this cost. The cost price of the land should include the purchase price, legal expenses of acquirement, and interest.

In regard to interest, it is logical and permissible to compute this item from the time of acquirement *up to the time the land is put on the market.** Such a charge is similar to that allowed by law where a company is constructing a railroad, and in other similar cases; for the concern is frequently required to make many improvements to the property before it can be turned over to the sales department.

The cost price of the land should also include the cost of surveying, platting, etc., the cost of clearing, and the cost of roads, fences, ditches, etc.

§ 158. Cost Per Lot

If these improvements are completed at the time the sales begin, the face of the books will show the total cost, and this can be apportioned to each lot. Where lots are fairly uniform, this may be done by dividing the total amount by the total number of lots, and making minor

*See Chapter XI for discussion of interest as part of cost.

adjustments for lots of irregular size. If the lots are irregular throughout, the cost should be apportioned according to area.

In fixing the cost per lot, there is sometimes a tendency to charge those lots likely to bring the highest prices with the highest cost. This is not good practice; for the reasons given above, the *cost* of any lot should be determined solely by its area, except where special expenditures have been made for improvement purposes.

§ 159. Cost Price When Improvements Are Incomplete

Unfortunately for the accountant, it is often decided to place lots on the market before all the contemplated improvements have been completed. In such cases the books will show a certain cost price when the sales commence, and this book price will increase continuously until the improvements are completed; in fact, the cost price is subject to monthly, weekly, and even daily changes.

This undesirable situation may be avoided by estimating in advance the cost of all improvements contemplated, and by adding to this a fair margin of safety. This amount should then be credited to an improvement reserve account, and debited to the cost price; charging all proper expenditures, as they occur, against this improvement reserve. The estimate does not involve or determine expenditures, and any excess which may remain can properly be credited to Gain account, for this account would have been proportionately greater had these improvements not been added to the cost.

§ 160. "Constant Cost Price"

If the above plan is followed, a fixed cost price is obtainable, which should remain in force until the books are closed, when it can be verified or changed if necessary. The

realized profits depend on this price; and, especially if the profits are determined by averaging all outstanding contracts, it is very advantageous to have as few changes as possible in the conditions.

Accounting for subdivision properties is a comparatively recent necessity, and few text-books even touch on it. It has been suggested recently by one eminent authority that the cost price should be recalculated each month; but it is believed that the plan here suggested is more scientific and more convenient. It would add a considerable burden to the bookkeeper of a concern handling constantly between twenty and thirty different subdivisions, if he had to calculate costs afresh each month. In practice it is found best to keep the cost price constant until the end of the fiscal period. At that time the improvement reserve account may be either increased or wiped out, according to the circumstances.

§ 161. Comparison of Cost Finding Methods

It should be clearly understood that the frequent revision of the cost price of lots is not an inaccurate method, for the final results of the two methods are identical. This can best be shown by the calculations in the following simple example:

Suppose that of twelve lots composing a small subdivision and each originally costing $360, one is sold each month during the year, and during that year improvements have been made continuously in such amounts that the cost of each unsold lot has increased $10 a month up to $480 at the last sale. In each case the selling price was $600, and each contract paid regularly $24 a month for every month of its existence, no "first payment" being demanded.

Calculated on the fixed price plan, the figures would be as follows:

Total sales, 12 lots at $600		$7,200
Total cost:		
Purchase price, 12 lots at $360	$4,320	
Add improvements $(11 \times 10) + (10 \times 10) + (9 \times 10)$, etc. $= 66 \times 10 =$	660	4,980
Total gain		$2,220
Total amount paid in, 78 payments at $24 each		1,872

Calculated on varying cost price, the figures are:

Total sales, as above		$7,200
Total amount paid in, as above		1,872
Gain:		
	1 lot at $240	
	1 " " 230	
	1 " " 220	
	1 " " 210	
	1 " " 200	
	1 " " 190	
	1 " " 180	
	1 " " 170	
	1 " " 160	
	1 " " 150	
	1 " " 140	
	1 " " 130	2,220

§ 162. **Check on Unsold Lots**

In the case of journal entries relating to the opening or cancelling of contracts, a valuable check on the unsold lots may be obtained by the following simple means:

1. Rule a special column on each side of the general ledger account, showing the cost of the property; and when the opening debit entry is made, insert in the special column on the debit side the total number of lots acquired.

2. Use similar special columns in the journal when making journal entries affecting sales or cancellations of

these lots, and also in the cash book when entering cash sales which are not journalized. Post the total of each of these special columns to the proper special column in the general ledger. The difference between the totals of the two ledger columns will then always show the number of lots unsold—a valuable figure which can be checked with the unsold lots as shown by the tickler and plats.

§ 163. Subdivision Property Expenses

Among the expenses incidental to the development of a large subdivision property, charges will frequently be found for such items as "steamboat for transporting purchasers," "cost of building a hotel for purchasers," "demonstration farms," etc. In such cases, it is proper to carry the actual cost of these items as assets, writing off proper amounts for depreciation. There is no doubt that it is better thus to eliminate these items from the Expense account and to carry them under separate accounts, the name of each of which indicates its purpose. The cost of operating and maintaining such ventures should, of course, always be charged to the Operating account.

§ 164. Advertising Expense

There is still another class of expense which calls for special treatment and which may be called "Advertising Expense." It consists of sums spent for newspaper and pamphlet advertisements, pictures, circulars, postage, etc., which, in the case of a large subdivision, soon become considerable.

Such items may be properly charged off directly to Profit and Loss, or they may be kept in an account by themselves and treated like the organization expenses of a new company. In the latter case there should be written off each year, either a fixed fraction of the whole sum, or an amount

proportionate to the sales for the period. Such an arrangement, honestly carried out, is proper and just to all concerned. For instance, considerable sums in advertising might be spent in the last part of a fiscal period, while no sales might be reported until the following period, and if the whole expense (from which no benefit has yet accrued) is charged off, it might unnecessarily, or even unfairly, impair the dividend. At the same time, all such accounts should receive a careful scrutiny and should never be allowed to run beyond their allotted term.

Expenditures for current advertising and selling of any subdivision may properly be kept by themselves, and at the end of a fixed period be carried direct to Profit and Loss.

§ 165. Advances to Settlers

Arrangements are sometimes made, in connection with subdivision properties, to advance to the settlers actually on the ground the cost of certain improvements. In one particular case in the writer's experience, the owners had made numerous sales through an agent who, it subsequently transpired, had been guilty of false representations. He had, in this way, induced a number of settlers to come to the locality and invest considerable sums; in fact, some had invested all their available means. Under such conditions the owners, though not legally responsible, felt that both justice and policy obliged them to assist the settlers who, through misrepresentation, had been induced to purchase their land.

A commissary was established in the midst of the colony, and placed in charge of a manager who was authorized to make specific advances to the settlers, of seeds, plants, and the requisite tools and fertilizers in proportion to their needs, as single men, married men without children, and married men with children.

NAME OF SETTLER	ADVANCED DURING THIS MONTH								TOTAL TO END OF LAST MONTH	TOTAL AD-VANCED TO DATE	CRATES SHIPPED THIS MONTH	NET RECEIPTS THIS MONTH	REMARKS
	Supplies	Seeds	Fertilizer	Tools	Ploughing	Crates	Sundries	Total					

Form 46. Colony Report

In order that the main office might be kept informed of these matters without being encumbered with detail, the manager was instructed to open an account with each settler and to charge him with all goods supplied under the above-mentioned instructions. At the end of each month he submitted a statement, which, as it may serve as a basis for similar reports and records elsewhere, is given here (Form 46).

This statement gives the commissary credit for the advances, charged at the usual current prices, and enables the storekeeper to make up his periodical profit and loss account in the usual way; the totals of these advances being charged to the individual settlers in the general books each month. As crops ripened, the manager marketed them, and credited the returns to the owner, as indicated in Form 46.

CHAPTER XXIII

EARNED PROFITS ON SUBDIVISION, DEVELOPMENT, AND SUBURBAN PROPERTIES

§ 166. Determination of Earned Profits

While the principle upon which earned profits on subdivision sales are determined is simple (See §§ 144, 145), difficulties often arise in practice. For instance, it frequently happens that a tract of land is divided into hundreds, or even thousands, of subdivisions—either farms or lots—and the number of purchasers also runs into the hundreds or thousands, each purchaser necessarily having his own account in a sub-ledger. Under such conditions, the payments are usually small, sometimes as low as one dollar a month, which makes it impracticable to compute the earned profit on each payment or on each contract, unless there has been adopted some method similar to that described in § 174. If such a method were adopted, profits would be arrived at by basing calculations on totals and averaging the results. For this the following facts are necessary: (1) cost price; (2) selling price; (3) profit, i.e., selling price less cost price; (4) payments actually made. Having these we can readily solve the equation:

$$\frac{\text{Payments made}}{\text{Total purchase price}} \times \text{total gain} = \text{earned profits}$$

The question then is, how best to obtain these figures, as they seldom appear on the face of the books found in real estate offices.

§ 167. The Cost Price

The cost price is discussed in Chapters X and XI. This price, however, is not necessarily uniform throughout an entire tract. Owing to their situation, some parts sell for a higher price. Sometimes one concern may sell out a division for another company, transferring outstanding contracts at their face value or at some figure based thereon. There will be no profit from these contracts to the buyer, and, in the event of cancellation, the cost price of the lot will be the amount paid for the contract. Or again, it may be advantageous to redivide a subdivision on account of differences in the sizes of the lots, the quality of the soil, and other similar variations.

These instances show that causes other than improvements may produce a variety of cost prices for the lots in one subdivision. In a case of this kind it is well to have different "series" of accounts for the subdivision affected, in order to keep together lots having the same cost price. The reason for this will be apparent when we come to the calculation of earned profits.

§ 168. The Selling Price

The average selling price is more difficult to determine, for it seldom happens that all the lots are sold at the same price. Corner lots and the larger lots command a higher price than others. Moreover, if the development of a particular tract has been successful, prices advance from time to time and a late purchaser may have to pay a higher price. It may also happen that one purchaser will buy a number of lots and thereby obtain a reduction from the current schedule.

Under such circumstances, the actual average selling price of the lots covered by the open contracts should be

obtained by listing the original amount of all the open contracts, and dividing this total by the number of lots included in those contracts.

§ 169. The Average Profit

The average profit is the difference between the average selling price and the average cost, and is represented by the following formula:

$$\frac{\text{Original amount of contracts}}{\text{Number of lots in contracts}} - \underset{\text{per lot}}{\text{average cost}} = \underset{\text{per lot}}{\text{average profit}}$$

§ 170. Amount of Payments Actually Made

The amount paid on any one series of outstanding contracts may not be readily ascertained from the balance of the general ledger account, which includes cancellations as well as payments upon contracts which have been fully paid up and closed.

In order to obtain this necessary figure, a list of the balances in the sub-ledger is taken off on an adding machine. To facilitate checking, it is convenient to use blank paper of journal size instead of the usual strips, showing a total at the end of each letter (i.e., each alphabetical division) and putting only two columns on a page; the totals under the various letters being then listed in order to obtain the grand total.

After this has been done, the list is put through the adding machine again, and the *original amounts* of these same contracts are added in a similar manner. The lists are then checked back, and at the same time there is inserted the number of lots covered by each contract, and, when the checking is completed, the total of these is obtained. The following example will show more clearly the appearance of such sheets:

	Original Price	No. of Lots	Balance Feb. 28, 1917
A	$150.00	1	$125.00
	250.00	2	232.50
	$400.00	3	$357.50
B	$300.00	2	$275.00
	300.00	2	270.00
	300.00	2	270.00
	500.00	4	340.00
	$1,400.00	10	$1,155.00
C	$300.00	2	$260.00
	150.00	1	125.00
	125.00	1	120.00
	$575.00	4	$505.00

We have now all the information necessary to solve the equation in § 169, viz:

1. Payments made are found by subtracting the balance of open contracts from the original amount of those contracts.

2. The original amount of the contracts is taken from the machine list.

3. The number of lots also is taken from the machine list.

4. The average profit is found by subtracting the cost price (which is an established figure) from the average selling price, obtained by dividing the amount of the original sales by the number of lots in those sales.

§ 171. Reserve Profit Account

There is, however, a modification of this method of averaging profits which is preferable. In practice, the auditor may be unable to check every small item in all the accounts connected with these contracts; his time may be limited, or his instructions may not include it. His chief object is to see that a fair amount is carried to Profit and Loss account, and also to see that no profit is anticipated; in other words, that a proper reserve is maintained for uncompleted contracts.

This being the case, it is usually safer to calculate the *unearned* profits to be *retained* in the Reserve Profit account, and to carry all the surplus in the Gain account to Profit and Loss; rather than to calculate the *earned* profits to be carried to the Profit and Loss account. This calculation is formulated as follows:

$$\frac{\text{balances unpaid}}{\text{total selling price}} \times \text{total profit} = \frac{\text{unearned}}{\text{profits}}$$

If this plan is followed, the profit kept in reserve will always be sufficient to care for all uncollected portions of sales, and, even if no more payments be made, the Profit and Loss account will not be disturbed.

§ 172. Application of Rule

In order to prove the correctness of this rule, and also to show more clearly the various details, refer to the illustration in §§ 144 and 145, and assume that, instead of this property being sold as a whole, it was subdivided into 5,000 lots or tracts which were sold on time, the sales being completed as before in five periods, and the payments made regularly and deeds issued as the respective contracts were paid up, as shown in column "X" of the following tabulated

statement. In order to apply a double test, assume as a second hypothesis that—with the same sales and the same collections—payments were made with great irregularity and that some purchasers paid in advance and obtained their deeds, while others fell in arrears to such an extent that their payments were almost negligible. These figures are placed in column "Y."

The tract being divided into 5,000 lots and costing $60,000, the average cost price is $12 per lot; and the total selling price being $180,000, the average selling price is $36 per lot, yielding a profit of $24 a lot.

	Lots Sold	Collections	No. of Contracts Paid in Full and Deeds Given	
			"X"	"Y"
First period....................	2,000	$24,000	0	650
Second "	1,250	30,000	0	800
Third "	1,250	36,000	0	1,000
Fourth "	500	42,000	2,500	1,200
Fifth "	.....	48,000	2,500	1,350
Total....................	5,000	$180,000	5,000	5,000

In the following examples, the balances are worked out in detail from the tabular statement just given, in order to show exactly how these balances are arrived at. The different letters used have the following significance:

(a) is the balance appearing on the ledger.

(b) is obtained by adding the original amounts of all open contracts as explained in § 170.

(c) is also obtained from the sub-ledger as detailed in § 170.

(d) is the average profit per lot, obtained by reducing the following formula:

$$\frac{\text{Original amount of open contracts}}{\text{Number of open contracts}} - \text{cost per lot}$$

Earned Profits under Example "X"

At close of first period:

Balance of Gain Account (2,000 × $24).............. Cr. $48,000.00

(a) Balance of Contracts (2,000 × $36) — $24,000 = ... $48,000

(b) Original amount (2,000 × $36)........... $72,000

(c) Number of lots in open contracts = ... 2,000

(d) Average profit per lot = ... $24

$$\text{Earned Profit} = \$48{,}000 - \left\{\frac{\$48{,}000}{\$72{,}000} \times 2{,}000 \times \$24\right\} = \text{Dr. } 16{,}000.00$$

At close of second period:

Balance forward of Gain Account.................. Cr. $32,000.00

Add gain on 1,250 lots at $24........................ Cr. 30,000.00

Cr. $62,000.00

(a) $48,000 + (1,250 × $36) — $30,000 = ... $63,000

(b) $72,000 + (1,250 × $36) = ...$117,000

(c) 2,000 + 1,250 = ... 3,250

(d) $24

$$\text{Earned Profit} = \$62{,}000 - \left\{\frac{\$63{,}000}{\$117{,}000} \times 3{,}250 \times \$24\right\} = \text{Dr. } 20{,}000.00$$

At close of third period:

Balance forward of Gain Account.................... Cr. $42,000.00

Add gain on 1,250 lots at $24......................... Cr. 30,000.00

Cr. $72,000.00

(a) $63,000 + (1,250 × $36) — $36,000 = ... $72,000

(b) $117,000 + (1,250 × $36) = ...$162,000

(c) 3,250 + 1,250 = ... 4,500

(d) $24

$$\text{Earned Profit} = \$72{,}000 - \left\{\frac{\$72{,}000}{\$162{,}000} \times 4{,}500 \times \$24\right\} = \text{Dr. } 24{,}000.00$$

At close of fourth period:

Balance forward of Gain Account.................. Cr. $48,000.00

Add gain on 500 lots at $24.......................... Cr. 12,000.00

Cr. $60,000.00

(a) $72,000 + (500 × $36)

(b) $162,000 + (500 × $36) — (2,500 × $36)* = $90,000

(c) 4,500 + 500 — 2,500 = ... 2,500

(d) $24

*Lots deeded.

$$\text{Earned Profit} = \$60{,}000 - \left\{\frac{\$48{,}000}{\$90{,}000} \times 2{,}500 \times \$24\right\} = \text{Dr. } 28{,}000.00$$

Cr. $32,000.00

At close of fifth period:

The earned profits must be:

$\frac{48{,}000}{180{,}000}$ of $120,000 (total profits), which is $32,000.

Earned Profits under Example "Y"

At close of first period:

Balance of Gain Account .... Cr. $48,000.00

(a) Balance of Contracts $(2{,}000 \times \$36) - \$24{,}000 =$ $48,000

(b) Original amount of open contracts $(2{,}000 \times \$36) - (650 \times \$36) =$ $48,600

(c) Number of lots on open contracts, $2{,}000 - 650 =$ 1,350

(d) Average profit per lot = ... $24

$$\text{Earned Profit} = \$48{,}000 - \left\{\frac{\$48{,}000}{\$48{,}600} \times 1{,}350 \times \$24\right\} = \text{Dr. } 16{,}000.00$$

At close of second period:

Balance forward of Gain Account .... Cr. $32,000.00

Add gain on 1,250 lots at $24 .... Cr. 30,000.00

Cr. $62,000.00

(a) $\$48{,}000 + (1{,}250 \times \$36) - \$30{,}000 =$ $63,000

(b) $\$48{,}600 + (1{,}250 \times \$36) - (800 \times \$36) =$ .. $64,800

(c) $1{,}350 + 1{,}250 - 800 =$ 1,800

(d) $24

$$\text{Earned Profit} = \$62{,}000 - \left\{\frac{\$63{,}000}{\$64{,}800} \times 1{,}800 \times \$24\right\} = \text{Dr. } 20{,}000.00$$

At close of third period:

Balance forward of Gain Account .... Cr. $42,000.00

Add gains 1,250 lots at $24 .... Cr. 30,000.00

Cr. $72,000.00

(a) $\$63{,}000 + (1{,}250 \times \$36) - \$36{,}000 =$ $72,000

(b) $\$64{,}800 + (1{,}250 \times \$36) - (1{,}000 \times \$36) =$ $73,800

(c) $1{,}800 + 1{,}250 - 1{,}000 =$ 2,050

(d) $24

$$\text{Earned Profit} = \$72{,}000 - \left\{\frac{\$72{,}000}{\$73{,}800} \times 2{,}050 \times \$24\right\} = \text{Dr. } 24{,}000.00$$

At close of fourth period:

Balance forward of Gain Account....................	Cr. $48,000.00
Add gains 500 lots at $24..............................	Cr. 12,000.00
	Cr. $60,000.00

(a) $72,000 + (500 × $36) — $42,000 = ... $48,000
(b) $73,800 + (500 × $36) — (1,200 × $36) =.. $48,600
(c) 2,050 + 500 — 1,200 =................. 1,350
(d) $24

$$\text{Earned Profit} = \$60{,}000 - \left\{\frac{\$48{,}000}{\$48{,}600} \times 1{,}350 \times \$24\right\} = \text{Dr. } 28{,}000.00$$

Cr. $32,000.00

At close of fifth period:
As in "X" = $32,000

By contrasting extreme results in the matter of advance payments and payments in arrears, these two examples afford an additional proof of the statement that earned profits in any given case depend solely upon, and are proportioned to, the cash actually paid in, together with other credits, regardless of arrears or of advance payments.

§ 173. Alternative Methods

It may be worth while, in passing, to mention a few methods of calculating earned profits not based on the principles above stated and to show the possible difficulties or errors which may arise in relation to each.

1. It is sometimes attempted to apply the formula for earned profits, as stated in § 145, to the controlling account in the general ledger, instead of to the balances taken from the sub-ledgers. This is not to be recommended as it is often difficult to get the proper figures from the controlling account, owing to entries made in it relating to cancellations, transfers, etc., and this difficulty is materially increased if the accounts have been running for a number of years.

2. Another method is to use the following formula:

$$\left.\begin{matrix}\text{Profits in full on}\\ \text{all lots deeded}\end{matrix}\right\} + \left\{\begin{matrix}\text{proportion of profits}\\ \text{on uncompleted sales}\end{matrix}\right\} = \text{earned profit}$$

This method presents the difficulties mentioned in connection with the preceding method, together with others peculiar to itself. The chief source of error lies in the fact that partial profits on any given lot are taken each period as earned, and when the lot is finally paid for and a deed given therefor, the entire profit is taken, including the partial profits already taken—an evident duplication of profits, which leads toward disaster.

3. Another and more usual plan of calculating earned profits is to employ the following formula:

$$\frac{\text{Total receipts}}{\text{Total sales}} \times \text{balance of Gain account}$$

The fallacy of this method is that the receipts and the sales cover all the transactions relating to the open contracts since the beginning of these contracts, while the balance of the Gain account is being periodically diminished by the profits regarded as earned. If sales have been made with regularity, the results *may* be approximately correct; if, on the other hand, they have been irregular, serious error mav creep in.

§ 174. Special Subdivision Ledger

It is frequently difficult to ascertain the earned profits from subdivision property, owing to the large number of items and to the various causes explained above. Special forms of ledger (Forms 11, 15, §§ 20, 23) have therefore been devised, showing at all times the amount of profit earned and unearned on each lot under sale.

It will be seen that the headings provide for all the essential facts; the date of the contract and the original amount of the ledger entry being shown above the money column. The form also shows the method of making the first entry, which would appear on the journal as follows:

Eureka Gardens Contracts...........................	$250	
To Eureka Gardens Purchase.................		$125
" " " Gains.....................		125

According to the terms of this contract, the payment is $10 cash and $10 a month. In the "Debits" column is entered the amount of $250 and in the "Reserve" column $125. Heading the "Reserve" column there would also be shown the figure "50," indicating that, of every dollar paid in, 50 cents is "reserve," or unearned profits. It may be noted that on these forms unearned profits are called "reserve," so that in case the customer should see the ledger account (as he often wishes to do) his curiosity may not be excited as to the amount of profit yielded by his purchase.

As succeeding payments are made, appropriate entries are made in the "Reserve Realized" column. For instance, each $10 appearing in the "Credits" column will show $5 in "Reserve Realized."

One important result of the use of such ledgers is that, by adding all the entries in the "Reserve Realized" column for any one month, the amount of earned profits from this particular source during that month may be positively ascertained, and this renders possible the preparation of accurate monthly statements of actual earnings.

A further advantage appears at the end of the year, when a trial balance of the entire ledger is taken off, showing the balances due on contracts and the balances of "Reserve." The difference between the totals of the "Reserve" and the "Reserve Realized" columns shows the amount of unearned profits which must remain in the Gain account. The surplus in Gain account above that amount may, of course, be safely carried to Profit and Loss.

It will sometimes happen that the reserve appropriation cannot be accurately expressed in an even number of cents. In such case, the reference figure shown at the head of the

"Reserve" column should be the number of cents next below the actual amount, omitting all fractions. For instance, supposing the profits were \$128 in the instance given above, the exact figure would be 55.2; the .2 is omitted, and, in order to keep the book in balance, the slight difference (which in this case would be 50 cents) is entered on a "balancing" account for the subdivision. The total amount of such fractional entry is so small that it will be perfectly safe to carry this balancing account and to write off a portion each year, depending largely upon the ratio of total cash collections for any period to total amount of contracts issued.

§ 175. Use of Special Ledger

There is no difficulty in transferring to the special ledger shown in Form 11 (§ 20) or Form 15 (§ 23) a set of accounts which have been kept in ordinary ledger form, the procedure being as follows:

A trial balance showing the balances of contracts outstanding is taken off the old sub-ledger, and the following fraction is worked out:

$$\frac{\text{Balance of Gain account} \times 100}{\text{Balance due on contracts}} = \begin{array}{l}\text{Number of cents in each dollar}\\ \text{uncollected, which is un-}\\ \text{earned profits}\end{array}$$

Each of the debit balances on the trial balance is then multiplied by this number of cents by means of a calculating machine, and the amount of the profit is set against the balance of the contract. The total of these being added, the footings prove themselves, for the total balances multiplied by the number of cents of unearned profits should equal the total gain. In such cases a small amount is usually left over, as it seldom happens that the fraction yields a whole number; and this sum is carried in the balancing account and should be written off in the manner suggested above.

It will be seen that the extra labor of keeping the ledger shown in Form 15 is slight, and is more than offset by the accurate results obtained. Form 15 is especially designed for those cases where no interest, taxes, or other charges are made against the account—in other words, where each payment applies directly and entirely to a reduction of the principal; while Form 11 is applicable to mortgages or contracts where there are interest and other charges and it offers equal advantages. The method of using the ledger shown in Form 11 differs from that required in connection with Form 15, inasmuch as in the former the "Reserve" columns are affected only when a payment reduces the balance to an amount smaller than it was when the last previous entry was made in the "Reserve" columns. In other words, if a purchaser makes payments covering interest, or any other charge, such payments do not affect the reserve.

The ledgers shown in Forms 11 and 15 have been in use for a number of years and the results obtained from them are entirely satisfactory. They not only greatly reduce the work of an auditor, but they do away with all the uncertainties; giving positive, reliable figures instead of the approximations obtained by the methods described in § 168 *et seq.*

§ 176. Holding Subdivision Properties

Subdivision properties are held under similar conditions and subject to the same rules as any general property. The only difference in treatment required is the frequent verification of the plats or lists showing the unsold lots, and the comparison thereof with the balance of the account showing the cost price; for it is evident that the great number of detailed sales found in any larger subdivision may easily lead to errors unless a constant watch be kept.

CHAPTER XXIV

SELLING CONTRACTS

§ 177. Definition of Selling Contract

A "selling contract" is an agreement between the owner of land and an agent who undertakes the sale of his property. Under such a contract the concern is therefore an agent, usually acting under a special agreement and having clearly defined rights, duties, and powers. The terms of such contracts vary greatly, but as a rule they give an agent the exclusive right for a definite time to sell, under stipulated conditions.

Frequently the agent undertakes to bear all or part of the expense of advertising, and sometimes that of development also. The agreement usually prescribes the manner in which the agent shall make payments to the owner, which is generally on a percentage basis, such as 50% of the cash collected monthly, or during some other stated period. The selling contract, like other agency contracts, does not necessarily oblige the agent to buy or to pay for the land until he has sold it.

§ 178. Classes of Selling Contracts

The following examples are given as typical selling contracts:

1. A contract under which the agent undertakes to sell certain described property, such as lots, at an average price per lot, and to remit periodically to the owner a certain portion of the cash receipts. All that the agent obtains

above the average price is his profit, with or without the addition of any payments on cancelled contracts. In the final settlement, he is obliged to pay only for such lots as the owner may convey to purchasers. An example of this class of contract is given in § 200.

2. Contracts under which a number of lots, or similar property, are placed in the hands of the agent, the lots having varying prices specified in the agreement, but the other conditions being similar to those of the first class.

3. Contracts under which the owner gives the agent sole selling rights to property at a fixed price per acre, or other unit of value, the agent undertaking all expense of developing, improving, advertising, selling, demonstrating, etc. In such cases the selling price is fixed in various ways; sometimes it is left to the agent, or a minimum price is stipulated. The method of paying the owner is set forth in the contract, and there is occasionally a further agreement that, after the owner has received the price per unit agreed upon, and after all the expenses of developing, etc., mentioned above, have been repaid to the agent, the net profits (if any), or the net profits above a named amount, are to be divided between the owner and the agent on the basis prescribed by the contract. An example of this kind of contract is found in § 204.

§ 179. Treatment of Selling Contracts in the Accounts

Under all forms of selling contracts, the selling price of lots sold is treated as an asset, and the payment due to the owner as a liability, although the liability is contingent upon the completion of the contract made with the purchaser. For this reason it is advisable to show such liabilities in the balance sheet as an item by themselves. (See § 200, account No. 21, and § 204, account No. 28.) The opening journal entry is of the following form:

Contracts	$......	
To J. Doe, Owner......		$......
" Gain on Sales....................		......

As collections come in, payments are made to J. Doe, owner, and debited to his account, the balance of which shows the remaining amount due him for properties covered by contracts. Care should be taken in drawing the balance sheet to show that this class of liability is contingent upon the contracts being completed.

Special conditions are frequently inserted in selling contracts, and it is necessary in each case that the original agreement between the owner and the agent be examined by the accountant. Such agreements form a prolific source of contention, and the greatest care should be taken to insure the proper recording of all points likely to cause misunderstanding, such as the land covered, the term of contract, the method of payment, the sharing of commissions and expenses, and the nature of any expense to be borne exclusively by either party.

CHAPTER XXV

ANALYSIS OF A TYPICAL TRIAL BALANCE*

§ 180. Clean Bookkeeping

Bookkeeping has been defined as "a systematic record of business transactions in a form conveniently available for reference with a view to ascertaining with the minimum amount of trouble at any time:

1. The detailed particulars of the transaction undertaken.
2. Its cumulative effect upon business and its financial relations to others.

"The ideal of any system of bookkeeping is the maximum of record with the minimum of labor."

It is proper at this point to lay stress on the importance of what may be called "clean" bookkeeping, by which is meant not merely the absence of blots, erasures, and corrections, but clean-cut, definite, and precise entries, so that each item in the trial balance shows definitely some one thing.

Perhaps one of the most familiar examples of what is not "clean" bookkeeping is the Merchandise account, formerly so often found in the ledgers of mercantile concerns, in which the debits consisted of:

Purchases
Freight
Drayage
Goods sold and returned
Labor

*A bracketed number preceding a section heading indicates the number under which the account discussed in that section appears in the trial balance shown on pages 222-225.

Allowances and discounts
Change in inventories
etc., etc.

and the credits included:

Sales
Goods bought but returned by the concern
Discounts and allowances
Inventories
etc., etc.

As the balance of such an account in itself meant nothing, other accounts are now substituted, such as:

- Purchase accounts, consisting of debit charges for goods bought, the only credits being for goods returned to creditors.
- Sales accounts, into which are brought credit entries for all sales, the only debits being goods returned by customers.
- Interest accounts, divided into (1) Interest and Discount Paid, and (2) Interest and Discount Received, etc., etc.

The balance of each of these accounts has a definite meaning. In the purchase accounts and sales accounts, for instance, the balances show respectively the actual net purchases and sales of the period, a knowledge of which is essential to good management. Such clean-cut accounts are important to a real estate concern, especially to one doing a large business in time sales. Attention has already been called to this matter (Chapter XXI) in connection with cancellation of contracts.

In like manner, the Real Estate account should be kept "clean" and should be a debit account, the difference between the balance of this account and of "Sales" being, in fact, a perpetual inventory of unsold property. The sales

accounts should show the sales divided in such manner as convenience may suggest; "Commissions" should be divided into "Commissions Earned" and "Commissions Paid."

It is possible that immense volumes of business may be transacted in which commissions "earned" and "paid" are equal. In such a case, the usual Commissions account, containing commissions earned and commissions paid, would show no balance, and the trial balance would therefore give no direct indication of these transactions. Probably the account as shown in the profit and loss statement would not, unless analyzed, indicate the business really transacted. These defects are remedied by a separation of the accounts, and when this is done all statements taken from the books show clearly the result of each set of transactions. The same principle applies to "Interest Earned" and "Interest Paid," "Options Granted" and "Options Bought," "Rents Collected" and "Repairs." The keeping of such accounts adds nothing to the labor, for in either case each item must be posted once and once only. The advantage of this method will be further exemplified in connection with the preparation of monthly reports in Chapter XXVII.

§ 181. A Typical Trial Balance

The trial balance shown on pages 222-225 brings in examples of all the types of accounts usually required in real estate accounting. It affords a convenient basis for the study of such accounts, by providing examples of the various methods of calculating profits, and illustrating the difficulties or irregularities which may occur. This trial balance is based on one taken from the books of a concern operating about thirty subdivision properties. The figures are left practically as they were found in the course of auditing, and the trial balance as given may therefore be considered an example from actual practice.

The method of dissecting accounts on analysis paper, as shown in connection with the trial balance, is familiar to accountants and should be clear to any reader. The various columns are introduced in order to simplify the preparation of proper schedules to accompany the balance sheet, and also to prove all new entries made, especially those affecting Profit and Loss, by checking the balance of the account shown on the sheets against the account in the ledger after all closing entries have been made.

The statement below is a summary of the trial balance shown on pages 222 to 225. Its total is, naturally, less than the total of the trial balance, as sundry accounts have been closed or adjusted.

SUMMARY

	Dr.	Cr.
Profit and Loss..........................	$99,158.48	$152,170.49
Real Estate..............................	779,356.89	
Contracts	568,433.33	
Profits in Reserve........................		361,790.37
Accounts Receivable......................	1,477.00	
Accounts Payable.........................		695.71
Balance Sheet Items......................	102,804.52	1,036,573.65
	$1,551,230.22	$1,551,230.22

§ 182. (1) Accounts Payable (Cr. $3,420)

If business is conducted on a cash basis and all current accounts are paid immediately on approval, it may not be necessary to carry the Accounts Payable account throughout the year; but when a balance sheet is prepared, it is proper to open such an account in which to enter all unpaid current accounts payable. Payment of such accounts payable should be made on regular days, weekly or monthly. In either case, all such accounts as "Pay-rolls" should be

closed, if possible, a day or two before the pay day, e.g., Thursday evening if Saturday is pay day. This enables the clerical force to make out the pay-rolls in time to have them properly checked, distributed, entered, and vouched for payment. The payment of accounts on other than regular days should be discouraged, as it leads to the loss of much valuable time.

§ 183. (2) **Advertising** (Dr. $12,114.02)

This account should include all charges for newspaper advertising, pamphlets, maps, and postage thereon, advertising agents, etc. The total is carried to Profit and Loss.

§ 184. (3) **Automobiles** (Dr. $1,138.02)

This account is intended to represent the actual value of motor cars owned by the concern. Three of the cars being new, no depreciation was taken on them. A fourth car had been reduced annually by 25% of its original cost, and it is believed this is a fair standard rate. All repairs are charged to the Expense account direct; for if they were charged to Automobiles account, the calculation of depreciation would be involved unnecessarily. Some conservative business men claim that the life of a motor is so uncertain a quantity that the original cost of all cars should be charged direct to Expense, but this is a rather extreme view inasmuch as a second-hand car has an actual selling value.

§ 185. (4) **Bills Payable** (Cr. $81,340)

A schedule should be prepared showing the items composing the total of this account, the due date of each note and an indication of the purpose for which it was given, e.g., "In payment for Barnes land," "Bank loan," etc.

THE ALPHA
ANALYSIS OF TRIAL

Acct. Nos.	Accounts	Trial Balance		Profit & Loss	
		Debit	Credit	Debit	Credit
1	Accounts Payable		$3,420.00		
2	Advertising	$12,114.02		$12,114.02	
3	Automobiles	1,138.02		400.00	
4	Bills Payable		81,340.00		
5	Bills Receivable	1,250.00		75.00	
6	Brick-yard Royalties		1,300.00		
7	Building—Green	1,250.00			
8	" Black	72.50		72.50	
9	" Brown		325.00		
10	Cancellation Profits		3,400.00		$3,445.00
11	Capital Stock		305,000.00		
12	Charity	37.00		37.00	
13	Commissions Earned		5,220.00		5,220.00
14	" Paid	8,325.00		8,325.00	
15	Contracts	165,770.00			
16	" Payable		8,002.40		
17	Dawes Purchase	8,640.00			
18	Directors' Meetings	185.00		185.00	
19	Dividends Unpaid		520.00		
20	Eureka Gardens Contracts	2,460.00			
21	" " Purchase		1,375.00		
22	" " Gains		1,330.00		
23	" " Expense	40.00		40.00	
24	Expense, General	12,440.00		12,440.00	
25	" Legal	1,522.00		1,522.00	
26	" Mortgage	548.50			
27	Fairmount Contracts	1,915.00			
28	" Purchase		1,200.00		
29	" Gains		1,200.00		
30	" Expense	5,795.00			
31	Gain on Sales		88,045.84		17,857.32
32	Grandville Contracts	1,827.42			
33	" Purchase	5,378.00			
34	" Gains		1,056.80	395.20	
35	Handbook	985.00			
36	Hilton, A. B	130.00			
37	Improvements	10,000.00			
38	Insurance	711.28		711.28	
39	Insurance Mortgage	283.75			
40	Interest Earned		9,840.00		9,840.00
41	" Paid	4,640.00		4,640.00	
42	" Mortgage Payable	11,120.00		11,120.00	
43	" Overdue Mtge. Pble.		120.00		
44	" Mortgage Receivable		2,400.00		2,400.00
45	" Overdue Mtge. Rec.	1,178.10			
46	" Unearned		3,529.82		1,400.08
47	Judgments	925.00			
48	Kingslake Contracts	61,799.88			
49	" Purchase	1,272.11			
50	" Gains		106,902.00		
51	" Expense	83,370.60			
52	" Lots	751.90			
53	" Commissions	461.40		461.40	
54	" Owner				
55	Ladore Contracts	30,506.00			
56	" Purchase	38,840.00			
57	" Gains		25,470.00		10,066.00
58	" Expense	4,229.04			
59	" Commissions		1,580.00		
60	" Town Lots	10,560.00			

LAND COMPANY

BALANCE—DECEMBER 31, 1916

	Real Estate	Contracts	Profits in Reserve	Accts. Receiv.	Accts. Payable	Balance Sheet Items	
	Debit	Debit	Credit	Debit	Credit	Debit	Credit
1							$3,420.00
2							
3						$738.02	
4							81,340.00
5						1,175.00	
6							
7	$1,250.00						
8							
9							325.00
10							
11							305,000.00
12							
13							
14							
15		$165,770.00					
16							8,002.40
17	8,640.00						
18							
19							520.00
20		2,205.00					
21							1,195.00
22			$1,210.00				
23							
24							
25							
26						548.50	
27		1,915.00					
28							1,200.00
29			1,200.00				
30	5,795.00						
31			70,188.52				
32		1,827.42					
33	5,378.00						
34			1,452.00				
35						985.00	
36				$130.00			
37	10,000.00						
38							
39						283.75	
40							
41							
42							
43							120.00
44							
45						1,178.10	
46			2,129.74				
47				925.00			
48		61,799.88					
49	1,272.11						
50			51,738.11				
51	17,206.71						
52	751.90						
53							
54						11,000.00	
55		30,506.00					
56	45,569.04						
57			15,404.00				
58							2,500.00
59							1,580.00
60	10,560.00						

THE ALPHA

ANALYSIS OF TRIAL

Acct. Nos.	Accounts	Trial Balance		Profit & Loss	
		Debit	Credit	Debit	Credit
61	Life Insurance	2,120.00		2,120.00	
62	Malvern Hill Contracts	37,467.00			
63	" " Purchase	34,057.00			
64	" " Gains		23,022.00		9,922.19
65	" " Expense	7.25		7.25	
66	Manning, R.		212.00		
67	Mortgage Deficiency Account		2,000.00		
68	Mortgages Payable		257,422.30		
69	" Receivable	45,000.00			
70	" in Settlement	5,250.00			
71	Office Furniture	3,200.00		480.00	
72	" Fixtures	3,156.00		473.40	
73	Options Granted		5,200.00		
74	" Held	3,400.00			
75	Parkville Contracts	18,842.00			
76	" Purchase		8,725.00		
77	" Gains		9,796.00		1.87
78	" Expense	783.20		783.20	
79	" Commissions	275.00		275.00	
80	Petty Cash	75.00			
81	Postage	725.00		725.00	
82	Profit & Loss		75,405.10		
83	Profits		8,242.10		8,242.10
84	Prospect Park Contracts	1,158.98			
85	" " Gains		1,576.00		587.42
86	" " Purchase	3,402.00			
87	" " Expense	85.00		85.00	
88	Real Estate	473,130.13			
89	Rent Account		5,780.00		5,780.00
90	Repairs	1,245.60		1,245.60	
91	Rinders, T.	280.00			
92	" " Reserve		525.33		
93	Robinson, J., Trustee		210,418.52		
94	Salaries	23,805.00		23,805.00	
95	So. Bay Farm Contracts	212,814.00			
96	" " " Gains		239,657.65		72,388.65
97	" " " Purchase	95,580.00			
98	" " Villa Contracts	32,850.00			
99	" " " Gains		32,640.00		5,019.86
100	" " " Purchase	29,550.00			
101	" " Front Purchase	19,560.00			
102	" " Expense	32,805.00		11,000.00	
103	" " Commissions	4,750.00		4,750.00	
104	" " Reserve		72,000.00		
105	Sperry, J. M.	422.00			
106	Stationery & Printing	472.00		472.00	
107	Stumpage		6,250.00		
108	Suspense	750.00			
109	Taxes	398.63		398.63	
110	" Mortgage	308.15			
111	Torbay Heights Contracts	11,283.00			
112	" " Purchase		4,450.00		
113	" " Gains		5,220.00		
114	" " Townley, J. R.		470.00		
115	Treasury Stock	22,000.00			
116	Cash—Superintendent	120.00			
117	Cash in Bank	7,990.40			
		$1,621,588.86	$1,621,588.86	$99,158.48	$152,170.49

LAND COMPANY

BALANCE—DECEMBER 31, 1916

	Estate Real	Contracts	Profits in Reserve	Accts. Receiv.	Accts. Payable	Balance Sheet Items	
	Debit	Debit	Credit	Debit	Credit	Debit	Credit
61							
62		37,467.00					
63	34,057.00						
64			13,099.81				
65							
66					$212.00		
67							2,000.00
68							257,422.30
69						45,000.00	
70						5,250.00	
71						2,720.00	
72						2,682.60	
73							5,200.00
74	3,400.00						
75		8,837.05					
76							3,950.00
77			4,564.18				
78							
79							
80						75.00	
81							
82							75,405.10
83							
84		1,158.98					
85			694.87				
86	3,402.00						
87							
88	465,580.13						
89							
90							
91					13.71		
92							525.33
93							210,418.52
94							
95		212,814.00					
96			167,269.00				
97	107,580.00						
98		32,850.00					
99			27,620.14				
100	35,550.00						
101	23,365.00						
102							
103							
104							72,000.00
105				422.00			
106							
107							
108						750.00	
109							
110						308.15	
111		11,283.00					
112							4,450.00
113			5,220.00				
114					470.00		
115						22,000.00	
116						120.00	
117						7,990.40	
	$779,356.89	$568,433.33	$361,790.37	$1,477.00	$695.71	$102,804.52	$1,036,573.65

§ 186. (5) **Bills Receivable** (Dr. $1,250)

This account also should be accompanied by a schedule similar to that mentioned above. Each item should be examined, and if any one appears to be of doubtful value, it should be written off to Profit and Loss or to a "Suspense" account. In the instance given, notes aggregating $75 were, after consultation with the officers of the company, treated as worthless.

§ 187. (6) **Brick-yard Royalties** (Cr. $1,300)

This is a typical royalty account, a brick-yard having leased a portion of certain property for the purpose of working a clay bed thereon, paying as rental a specified royalty on every thousand bricks burned. Monthly statements have been submitted showing the brick manufactured, and these, checked against the brick-yard "inventories" and "sales" records, are found to be correct.

As the working of this clay bed resulted in several large excavations, the land worked over was rendered useless for any other purpose. The royalties were therefore credited to the property in question, thus reducing its "cost" and providing for an increased profit when the salable part should be disposed of. If the entire tract had been leased, such royalties would have been credited in the above manner until they equalled the book value of the land, and all amounts in excess of that would be carried to Profits account.

§ 188. (7) **Building—Green** (Dr. $1,250)

This account shows the cost to date of a house which the concern agreed to build for Mr. Green, the final cost (not to exceed $1,500) to be charged to his "Contract." The house not yet being completed, the amount spent stands as an asset. Since this is an improvement to real estate,

the amount thereof is carried in the "Real Estate" column (§ 58).

§ 189. (8) Building—Black (Dr. $72.50)

This account represents a house which it was agreed should be built for Mr. Black for $2,500, that amount being included in the mortgage which he has given, and which was placed originally to the credit of this account. On completion the house is found to have cost $2,572.50, the excess of $72.50 being a loss to the company.

This loss having been already incurred and the amount (as is usual in such cases) being inconsiderable, it is charged direct to Profit and Loss. It would have been equally correct to have charged it against Gain on Sales, but a great number of such cross-entries would tend to obscure the Gain on Sales account and it is better to charge such amounts off direct.

§ 190. (9) Building—Brown (Cr. $325)

This account is for a house to be built for Mr. Brown at a cost of $2,000, which amount was charged to his contract or mortgage account. The house is not yet completed, and the unpaid balance of $325 appears among the liabilities.

§ 191. (10) Cancellation Profits (Cr. $3,400)

This account has been credited during the past year with all payments made on sales which have been cancelled. (See § 153.) These payments having been actually received, the amount goes to the Profit and Loss account. The entry described in § 200 increases the original amount by $45.

§ 192. (11) Capital Stock (Cr. $305,000)

The balance of this account should be verified and proved to be in accordance with the capital stock certificates out-

standing. (See § 296, also § 251.) A list of stockholders should be prepared by the auditor or secretary of the concern for purposes of checking and comparison.

§ 193. **(12) Charity** (Dr. $37)

The name explains the account, which shows all amounts given to charity. The total is carried to Profit and Loss.

§ 194. **(13) Commissions Earned** (Cr. $5,220)
(14) Commissions Paid (Dr. $8,325)

These accounts represent cash receipts and expenditures, or their equivalents, received by the concern acting as broker, or paid by the concern to agents who have sold its property. It is far better to keep these in separate accounts (see § 181), the balances being carried to Profit and Loss.

§ 195. **(15) Contracts** (Dr. $165,770)

This account includes all *general* sales on the instalment plan, exclusive of those secured by mortgage and of those described as "subdivision" sales. The balance must agree with the total of the Contracts accounts shown on the sub-ledger; and those contracts must be examined by the auditor to make sure that all proper cancellations have been made and that the total includes only "live" accounts.

§ 196. **(16) Contracts Payable** (Cr. $8,002.40)

These are contracts made or assumed by the concern, for which it is responsible. They usually represent the purchase price on properties which have been acquired. If they are numerous, a sub-ledger must be kept; but when comparatively few, the details of each can readily be "picked out" from the Contracts Payable account in the general ledger.

§ 197. **(17) Dawes Purchase** (Dr. $8,640)

This account represents the purchase price of a tract acquired from Mr. Dawes. The property is to be improved, but the plans for this work are not yet complete, and, since the matter is being held in suspense, the present account is kept until a final disposition can be made. (For final disposition on such accounts, see § 221.)

§ 198. **(18) Directors' Meetings** (Dr. $185)

The principle of paying fees to directors for attending meetings is spreading in this country, and if it is true that a thing is worth just what is paid for it, the practice is a good one. At all events, it tends to insure a better attendance at such meetings, and for that reason is worthy of adoption. The fees paid are, of course, chargeable direct to Profit and Loss.

§ 199. **(19) Unpaid Dividends** (Cr. $520)

Immediately after the close of the *previous* year, a dividend was declared which amounted to $27,142, and this amount was debited through the journal to Profit and Loss and credited to "Unpaid Dividends." As the dividends were paid the payments were charged from the cash book to this account, the balance showing the amount remaining unpaid. A list showing the amounts of all items included in this balance and the names of those to whom they were due, accompanied the annual report.

The payment of dividends in a corporation with a large number of stockholders necessitates the drawing and entering of a large number of checks. It is not necessary that each of these should pass through the general cash book, but if they do, a column headed "Dividends" should be provided. The usual method is to deposit in a special bank account the amount required to pay dividends, either in

one sum or smaller sums, as may be convenient, and to issue against this account special checks marked "Dividend Check." This renders the checking of this account a simple matter and tends to "clean" accounts.

§ 200. Eureka Gardens Accounts

(20)	Contracts,	Dr.	$2,460
(21)	Purchase,	Cr.	1,375
(22)	Gains,	Cr.	1,330
(23)	Expense,	Dr.	40

These four accounts relate to a subdivision which is being handled on a "selling contract" similar to that designated in § 178 as No. 1. The subdivision is a small one, in which there appear to have been included eighteen lots costing $90 each ($1,620 for all), and selling for a total of $2,950, thus yielding a gain of $1,330. The collections amount to $490, leaving due $2,460. Half the collections ($245) having been paid to the owners, there remains $1,375 to be paid to them as collections are made from the contract holders.

An examination of the contracts shows that those covering two lots, on which a total of $45 has been paid, are in default and the purchasers have stated that they will pay no more. These contracts were originally for $300. The following entry is made:

Eureka Gardens Purchase	$180	
Eureka Gardens Gains	120	
To Eureka Gardens Contracts		$255
" Cancellation Profits		45

The item for expense being payable by the concern is written off to Profit and Loss.

§ 201. **(24) Expense, General** (Dr. $12,440)

This account covers such items as:

Office rent
Telephones
Telegrams
Branch office rent and expenses
Motor car repairs

The items chargeable to this account are of great variety. It is well in each case to have a detailed list made and perhaps written on the head of the ledger account, showing exactly what items are included. The preparation of such a list is greatly simplified if a current analysis of the account is kept on Form 41 (§ 48).

§ 202. **(25) Expense, Legal** (Dr. $1,522)

This account includes attorneys' fees, together with recording and other legal fees which cannot properly be charged to the various customers.

§ 203. **(26) Expense, Mortgage** (Dr. $548.50)

This account shows all expenditures made on account of mortgages receivable and chargeable against specific mortgages, being entered in the mortgages receivable sub-ledger as charges to the income account of the various mortgages. In this account are included such items as paving and other liens, and very frequently attorneys' and court fees on mortgages in the course of foreclosure. The amount is carried forward as an asset.

§ 204. **Fairmount Accounts**

(27)	Contracts,	Dr.	$1,915
(28)	Purchase,	Cr.	1,200
(29)	Gains,	Cr.	1,200
(30)	Expense,	Dr.	5,795

These accounts relate to a tract handled under a selling agreement of type No. 3 (§ 178), covering 5,000 acres, which has been divided into ten-acre lots. The concern is to pay all the expense of advertising, etc., and remit to the owner 50% of all collections until he has received $15 an acre, when he will convey title to the concern.

This is a recent contract and the work done to date has been for the most part surveying and developing the land. At the present time, 8 lots have been sold for $2,400, of which $485 has been collected. No payments have yet been made to the owner, and the Purchase account therefore stands credited with 80 acres at $15 an acre. Attention may be called to the fact that under this agreement the concern loses nothing through reduced acreage on account of streets and roads, inasmuch as the owner is paid only for the number of acres covered by the deeds he grants.

The whole transaction being so new, all the balances of the Fairmount Contracts were carried forward into the balance sheet, the expenses being carried in the "Real Estate" column, as this money represents physical improvements from which there is a reasonable prospect that the concern will obtain a profit.

§ 205. (31) Gain on Sales (Cr. $88,045.84)

The method of treating this account has been fully described in Chapter XIII. On completing the calculations as there indicated, it is found that of this total, $17,857.32 has been earned since the last balance sheet, and is therefore to be credited to Profit and Loss.

§ 206. Grandville Accounts

(32)	Contracts,	Dr.	$1,827.42
(33)	Purchase,	Dr.	5,378.00
(34)	Gains,	Cr.	1,056.80

These accounts relate to a subdivision owned by the concern, which was bought some years ago under a "Contract Payable." Analysis of the sub-ledger shows that there are 108 lots under sale and that the original amount of the contracts was $7,607. The estimated book value of each lot is $14. The average profit, therefore, was $56.43 a lot (say $56), and the gain unearned and to be left in would be:

$$\frac{1827}{7607} \times 108 \times 56 = \$1,452$$

or more than appears in the Gain on Sales account.

This led to a further investigation and it was found that there remained unsold 348 lots, which cost $5,378, or $15.45 a lot. This increased price was caused by certain improvements on the property, not considered when the gain on sales was entered.

As the lots are selling for $100 to $150 each, it is evident that a cost price of $15.45 is reasonable; and in order to correct the errors, a charge of $395.20 is made against Profit and Loss and credited to the Grandville Gains account, which is now correct.

Note that account No. 33 is in fact a real estate account, the property being owned by the concern, and could with propriety have been kept in the real estate ledger. The account was opened when the property was purchased, and is kept because all employees familiar with the books have been accustomed to regard this account as showing the value of the unsold part of Grandville. Similar remarks apply to No. 34, which, in fact, is a part of the general Gain on Sales account.

§ 207. (35) Handbook (Dr. $985)

This account represents the cost of an advertising work published for free distribution. As few copies have yet left

the office, the amount is allowed to remain in the balance sheet.

§ 208. (36) Hilton, A. B. (Dr. $130)

This account represents advances made to a salesman, and is to be deducted from future commissions. It is typical of a number of accounts which appear in such trial balances. The account will be closed when these advances are repaid.

§ 209. (37) Improvements (Dr. $10,000)

This account is intended to contain all expenditures for improvements as suggested in § 58. As such disbursements are made they are immediately posted in the property ledger against the piece of property to which they refer. At the closing of the books at the end of the fiscal period, the total amount is charged to Real Estate, and until this time the balance of the property ledger will equal the Real Estate account *plus* the Improvements account. There are several very distinct and important advantages (§ 58) in keeping these items in a separate account. In the first place, by so doing the monthly report will show on its face all such expenditures. This is always important information and is essential where a fixed sum is to be spent annually on improvements. Furthermore, such an account provides automatically a list of all properties so improved, for the main facts are carried to the ledger accounts as follows:

June 15 Howard Co., Plumbing, No. 862.... $346.50

§ 210. (38) Fire Insurance, etc. (Dr. $711.28)
(39) Mortgage Insurance (Dr. $283.75)

The first of these accounts represents the amount paid by the concern for insurance on its own property against

fire and tornado and on rents. Insurance paid on contracts should be charged direct to the various purchasers. The second account represents cash paid by the concern for insurance on mortgaged properties. The items composing it are charged to the respective expense accounts in the mortgages receivable ledger. It is an asset of the concern and consequently should appear in its proper place on the balance sheet.

When damages are collected for insurance other than against fire, the accounts to be credited vary; but if the insurance is for rents, the amount paid by the insurance company is, of course, credited to Rent account. Damage to buildings caused by fire or tornado is sometimes repaired by the insurance companies, or an amount agreed upon may be paid in cash. In the first case, no entry is required on the books beyond a memorandum in the rent sub-ledger stating the facts. In the second case, if repairs have been made by the concern, the cost of them would naturally be charged to Repairs account, and the amount received from the insurance company should be credited to the same account.

In the event of total loss, where the property is owned by the concern and is not involved in any time sale, the insurance received is credited to Property account; but if the property is subject to a time sale, it must be credited to the account of the purchase, i.e., either to the contract or to the principal of the mortgage. If any arrangement is made with the purchaser to allow him the use of this money for the purpose of rebuilding, all amounts so advanced should be debited to the same account as received the credit.

In cases where the number of total losses is large, it is advisable to open a special insurance account, to which are credited all amounts collected for losses.

§ 211. **(40) Interest Earned** (Cr. $9,840)
(41) Interest Paid (Dr. $4,640)

These accounts afford another example of the advisability of keeping two ledger accounts for items not infrequently kept in one account. "Interest Earned" is credited with the interest charged to the general contracts, and with sundry interest which may be collected but which is not chargeable to "Overdue Mortgage Interest Receivable."

The "Interest Paid" covers all interest paid by the concern on loans, contracts payable, etc., with the exception of interest on mortgages payable. By keeping two separate accounts, the trial balance will always show how this important feature of the business is running.

§ 212. **(42) Mortgage Interest Payable** (Dr. $11,120)
(43) Overdue Mortgage Interest Payable (Cr. $120)

These two accounts receive all entries relating to interest on mortgages payable, the form of entry appearing in § 134. Account No. 43 shows that there is overdue $120 of interest, which is payable by the concern. The "Mortgage Interest Payable" is chargeable direct to the Profit and Loss account, while the "Overdue Interest" appears in the balance sheet as a liability.

§ 213. **(44) Mortgage Interest Receivable** (Cr. $2,400)
(45) Overdue Mortgage Interest Receivable (Dr. $1,178.10)

These items are similar to, but in their nature the reverse of, accounts Nos. 42 and 43.

§ 214. **(46) Interest Unearned** (Cr. $3,529.82)

This account is described in § 136 *et seq.,* and refers to cases where interest is included in the principal of "Mort-

gages Receivable" and "Contracts." The method of determining the amount which has been really earned is similar to that applied to the Gain on Sales account (see Chapter XX). In the case of the account appearing on the trial balance, it was found that $1,400.08 had been earned, and this amount is carried into the Profit and Loss account, the remainder forming one item of the profits in reserve.

§ 215. (47) Judgments (Dr. $925)

This account represents an amount due from a contractor who failed to carry out his agreements. Suit was instituted and a judgment obtained, which is of record and which it is believed will ultimately produce the amount of the debt.

§ 216. Kingslake Accounts

(48)	Contracts,	Dr.	$61,799.88
(49)	Purchase (§ 217),	Dr.	1,272.11
(50)	Gains (§ 218),	Cr.	106,902.00
(51)	Expense (§ 219),	Dr.	83,370.60
(52)	Lots (§ 217),	Dr.	751.90
(53)	Commissions (§ 220),	Dr.	461.40
(54)	Owner,	Dr.	11,000.00

These accounts represent a rather complicated purchase in which the concern bought a tract of about 12,000 acres, a part of which was waste land, such as swamps, etc. The tract was divided into ten-acre lots, and it was agreed that half the gross receipts should go to the owner until he had received $4 an acre, after which the concern was to reimburse itself for all expense incurred in connection with the land; any further receipts to be divided, one-fourth going to the owner and three-fourths to the concern. The tract was developed several years prior to the taking of the present trial balance and practically all of it was sold, the total

available acreage being 7,500 acres; the remaining acreage consisting of roads and unsalable land. An examination of the Contracts account showed that all cancellations had been made and that the balance represented "live" contracts.

§ 217. (49) **Kingslake Purchase** (Dr. $1,272.11)
(52) **Kingslake Lots** (Dr. $751.90)

This account represents the cost of adjoining land which the concern thought it wise to buy and for which it paid in cash upon receiving a deed. As this land is included in the general plat, it seemed most convenient to carry it in this manner. Account No. 52, Kingslake Lots, is also a real estate account and represents the cost of a number of residence lots which were platted from a part of this second purchase. Both accounts Nos. 49 and 52 are therefore real estate accounts and are carried out in that column.

§ 218. (50) **Kingslake Gains** (Cr. $106,902)

It will be noticed that the gains are larger than the contracts outstanding. This is accounted for by the fact that, during previous periods, no part of the Gains account had been carried to Profits, but was held in reserve on account of the heavy expense account. This gain is therefore on all sales made to this date, while the Contracts account has been continuously reduced by the monthly payments of purchasers. The method of determining and dividing these gains is shown in § 219.

§ 219. (51) **Kingslake Expense** (Dr. $83,370.60)

The balance of this account was so large that it called for special examination. It was found that all the items were for expenditures covered by agreements, under which they are repayable to the concern. In the case of one item of $11,000, necessary to perfect the title, the vendor being

short of funds, the concern had paid it under a separate agreement that it was to be deducted from the purchase price. As it was desired to dispose of the Expense account as quickly as possible, the following journal entries were made:

Kingslake Owner........................	$11,000.00	
To Kingslake Expense.............		$11,000.00
For cost of perfecting title, chargeable to the owner.		
Kingslake Gains.........................	$55,163.89	
To Kingslake Expense.............		$55,163.89
To charge Gains account with items of expense which prove to be uncollectible.		

It will be seen that the above entry properly disposes of the expense by reducing the profits on this tract. An analysis was then made of the sub-ledger trial balance and it was found that the original amount of outstanding contracts, including 541 lots, was $132,901.50; and that the average profit per lot was $205.66. The unearned "Gain on Sales," therefore, in round figures was as follows:

$$\frac{\$61{,}800}{\$132{,}900} \times 541 \times \$205.66 = \$51{,}738.11$$

Therefore, $55,163.89 was earned; and instead of carrying this into Profit and Loss, it was deducted from the expenses which were thereby reduced to $17,206.71, which amount was allowed to stand as a real estate expenditure to be deducted from next year's earned profits.

§ 220. (53) Kingslake Commissions (Dr. $461.40)

This amount, being a part of the expenses chargeable against the property, was written off to Profit and Loss account.

§ 221. Ladore Accounts

(55)	Contracts,	Dr.	$30,506.00
(56)	Purchase,	Dr.	38,840.00
(57)	Gains,	Cr.	25,470.00
(58)	Expense,	Dr.	4,229.04
(59)	Commissions (§ 222),	Cr.	1,580.00
(60)	Town Lots (§ 223),	Dr.	10,560.00

This group of accounts shows the transactions relating to a subdivision owned by the concern. It consists of five separate purchases, each of which was originally carried in the same manner as the Dawes account (§ 197). Upon closing the books, these were consolidated and it was found that 693 acres had been bought at a total cost of $51,833.

These various purchases were surveyed, platted, and divided into 567 lots of about one acre each, the difference being accounted for by streets, parks, etc. A part of the tract was subdivided into 181 city lots 50 × 100 feet, known as "Ladore Townsite." The estimated cost of these lots was $2,250, which was deducted from the total cost, leaving the net cost of the one-acre lots at $49,583, or $87.45 a lot. In calculating profits, etc., this in round figures is called $90.

The balance of Expense account, $4,229.04, was found to cover cost of road-making and other permanent improvements. Further improvements were contemplated which, it was estimated, would cost $2,500, making a total sum of $6,729.04. As it was desired that the total cost of these expenses should be added to the purchase price of the land, the following journal entry was made:

Ladore Purchase........................	$6,729.04	
To Ladore Expense................		$6,729.04

This being posted to the Expense account, left a credit balance of $2,500 as a reserve for future expenditures.

These operations brought the cost up to $56,312.04, or $99.32 a lot, which is called $100 when calculating profits. An analysis of the sub-ledger shows that 185 lots were sold, yielding an average profit of $102 per lot. As the original amount of these sales was $37,370, the unearned profits are as follows:

$$\frac{\$30{,}506}{\$37{,}370} \times 185 \times \$102 = \$15{,}404$$

This amount deducted from the gain of $25,470 leaves $10,066 to be carried to Profit and Loss.

§ **222. (59) Ladore Commissions** (Cr. $1,580)

These are commissions promised to agents who have made time sales. The liability for them is therefore contingent upon those sales being completed.

§ **223. (60) Ladore Town Lots** (Dr. $10,560)

At the beginning of the sale of Ladore lots, the concern offered to give a townsite lot to each purchaser of an acre lot. This arrangement is not uncommon and calls for special entries on the books. The most convenient method is to add the cost of the free lots to the cost of the purchased lots and deduct the sum from the price paid by the purchaser.

It is important that the record of lots selected to be so given away should be clearly marked on the plats; and, although the deed is not given until all the purchase money is paid, the records should be very clear in showing that these lots are reserved and therefore cannot be included as an asset. The form of journal entry would be as follows:

Ladore Contracts..........................	$......	
To Ladore Purchase		$......
" " Town Lots..................		......
" " Gains		......

In addition to the 181 townsite lots above mentioned, over 227 lots were purchased which had already been platted, giving a total of 408 lots at a cost of $11,114, which, in calculating profits, is figured at $30 a lot.

§ 224. **(61) Life Insurance** (Dr. $2,120)

It has been the custom of late years with many owners, especially in connection with subdivision properties, to guarantee that, in event of the decease of any purchaser during the life of a contract, the owner will convey to the estate of the deceased the property covered by the contract. This is loosely described as "Life Insurance," although the account actually represents the unpaid balances on contracts of purchasers who have died since the books were last closed. The entire amount is chargeable direct to Profit and Loss as an expense, there being no advantage in complicating entries by keeping a separate life insurance account for each subdivision.

CHAPTER XXVI

ANALYSIS OF A TYPICAL TRIAL BALANCE
(Continued)

§ 225. Malvern Hill Accounts

(62)	Contracts,	Dr.	$37,467.00
(63)	Purchase,	Dr.	34,057.00
(64)	Gains,	Cr.	23,022.00
(65)	Expense,	Dr.	7.25

This group of accounts represents a subdivision which was acquired in a manner different from any of those heretofore discussed. The Malvern Hill Land Company bought a considerable tract which was platted into town lots and placed on sale. A number of lots were sold and contracts given, some of which were paid up and deeds given to the purchasers. As some members of the Malvern Hill Company wished to retire, that company offered its entire holdings, consisting of unsold lots and open contracts, to the concern whose trial balance is under discussion, which bought them for a lump sum. When analyzed, it is found that the purchase price consisted of two items, one of which was the aggregate balances of the open contracts bought, and the other the cost of the unsold lots. As time went on, a number of the original contracts were cancelled, and the question arose as to whether the property thus acquired should be taken back on the books at the balance of the contract (which was really the cost price to the concern), or whether they should be taken in at the average cost per lot, the market value of one of these lots being the same as that of an adjacent lot which had not been sold.

It was decided that, in the case of a cancelled contract, the land should be taken in at the balance remaining unpaid on the contract, and this practice was continued for a year or more. The auditors then pointed out the confusion which was arising from having adjacent lots with widely divergent cost prices, and, when the balance was prepared, a list of all unsold lots was made. This showed that there were 1,392 of these lots and that they had cost $34,057.72, an average of about $25 a lot. Instructions were accordingly given that, in the event of any contract being cancelled, whether made originally by the Malvern Hill Company or by the concern, the entry therefor should be the following:

Malvern Hill Lots (cost price of a lot, $25)....	$......	
Malvern Hill Gain............................	......	
To Malvern Hill Contracts.............		$......

It will probably be admitted that in a contract of this description where the number of lots is large, this is a safe and conservative plan to follow, although objection may be raised as to its technical accuracy. In this particular case it was found that the amount of the contracts assumed by the concern, of which the balances were $37,467, had originally been $88,090; that they comprised 500 lots, which, taken on at a cost of $25 each, would then show an average profit of $150 per lot. These figures show that there are unearned profits amounting to $32,218, which is more than the total amount left in the Gain on Sales account, the discrepancy having been caused by the fact that many of the lots were originally bought at the face value of the contract.

§ 226. Malvern Hill Determination of Profits

As the existing contracts were more than half paid up, the question then arose as to what profit should be car-

ried to Profit and Loss, and the following plan was adopted as a compromise, recourse being had to the third method of calculation described in § 173. In this case the unearned profit was represented by the following fraction:

$$\frac{\$37{,}467}{\$88{,}090} \times \$23{,}022 \text{ (balance of Gains account)} = \$9{,}790$$

This would yield an unearned profit of \$9,790 and an earned profit of \$13,229. From this amount there was deducted 25% as a reserve, i.e., \$3,307.25; and \$9,922 was carried to Profit and Loss. The selection of 25% as the margin of safety was, of course, arbitrary, but the examples given in § 145 will show that it is a safe margin. Technical objections may be raised as to the accuracy of this method, and it may be claimed that the Gains account should have been increased to bring it up to \$32,218, the difference being charged against Profit and Loss. However, inasmuch as the contracts have been more than half paid, it was, in this instance, considered more equitable to follow the plan outlined above.

§ 227. (66) Manning, R. (Cr. \$212)

Mr. Manning is a customer who owns a number of houses from which the concern collects rent, making monthly returns to him. \$212 represents the net balance of rents for the last month, which has not yet been paid to him, and which is therefore carried among the accounts payable.

§ 228. (68) Mortgages Payable (Cr. \$257,422.30)
(69) Mortgages Receivable (Dr. \$45,000)

The nature of these accounts has been described in § 52 and Chapter XVI and the details of the total are shown in

a schedule accompanying the balance sheet, giving the following particulars of each mortgage:

Record number
Name of the holder
Property covered
Date due
Amount

§ 229. (67) Mortgage Deficiency Account (Cr. $2,000)
(70) Mortgages in Settlement (Dr. $5,250)

These accounts represent mortgages receivable to the amount of $5,250, which are in course of foreclosure and on which it is expected that a loss of $2,000 will be sustained (§ 121).

§ 230. (71) Office Furniture (Dr. $3,200)
(72) Office Fixtures (Dr. $3,156)

These accounts represent the actual cost of the articles described, less an annual depreciation at the rate of 15% on the outstanding balances. The amount of depreciation is frequently a matter of argument between the owners and the auditors. Where the item covers such articles as typewriters, adding machines, etc., probably 25% would be a fair proportion; on the other hand, where the principal items are solid fixtures, safes, etc., 15% seems to be a reasonable amount.

§ 231. (73) Options Granted (Cr. $5,200)
(74) Options Held (Dr. $3,400)

"Options Granted" are described in § 130. A statement accompanies the balance sheet, giving the number, name, property, and amount of each such option. Inasmuch as they have not yet been turned into contracts and

charged to Real Estate, this amount is carried in the balance sheet as a separate liability.

"Options Held" are options on real estate obtained by the concern and are included in the "Real Estate" column, as it is expected that each of them will be exercised and that the amount paid for the option will be deducted from the purchase price to be paid for the respective properties. In the event of any option lapsing, the amount paid therefor is chargeable directly to Profit and Loss.

§ 232. Parkville Accounts

(75)	Contracts,	Dr.	$18,842.00
(76)	Purchase,	Cr.	8,725.00
(77)	Gains,	Cr.	9,796.00
(78)	Expense,	Dr.	783.20
(79)	Commissions,	Dr.	275.00

This group of accounts refers to a tract which was handled under a selling contract. The entire tract consisted of 240 lots, to be sold at prices shown in a schedule attached to the original agreement. The concern had the exclusive sale, was to pay all expenses attached to the selling, and was allowed to retain all profits made above the schedule prcies.

The tract lay in a town several hundred miles from the home office and the subdivision was therefore managed through a local office, where detailed accounts of the contracts and sales were well and accurately kept. Until a few months before the date of this trial balance, no sub-ledgers for these contracts had been kept in the main office; and upon the auditors' comparing the balance of outstanding contracts, as shown on the general ledger, with a special report from the sub-office, it was found that the general ledger balance was some $10,000 in excess of the sub-ledger balance in the branch office. When the matter was investi-

gated, it was found that a number of reports had failed to reach the bookkeeper, and had therefore not been placed upon the general ledger.

For several years past, the auditors had recommended that a duplicate sub-ledger be kept in the main office, and that weekly detailed reports be rendered from the branch office to keep up this duplicate set of books, which could then be compared periodically with the branch office books and the accuracy of both insured. When this serious discrepancy was discovered, the concern agreed to adopt their auditors' suggestions, and since that time, such troubles have not appeared. Upon closing the books it was necessary to make the following journal entry:

Parkville Purchase........................	$4,775.00	
Parkville Gains............................	5,775.00	
To Parkville Contracts..............		$10,004.95
" Parkville Profits.................		545.05

This brought the balances of the outstanding contracts down to $8,837.05. An analysis showed the original amount of these contracts to have been $20,320, while the original profit had been $10,495. The unearned profits were therefore $4,564.18, which was slightly more than the amount left in the Profits account. The difference of $1.87 was then charged against the Profit and Loss account.

It will be noted that the Purchase account is here a credit account and represents a liability contingent upon the completion of the contracts by the purchasers.

§ 233. **(80) Petty Cash** (Dr. $75)

The method of keeping petty cash is described in § 14. $75 was the amount originally placed in the hands of the cashier.

§ 234. **(81) Postage** (Dr. $725)

This title explains itself, it being understood that this amount is the current office postage and does not include the amount paid for sending out circulars in quantity, which should be charged to Advertising. It is an excellent practice to keep a mailing book, in which is entered each letter mailed, with the date, name, and amount of postage. This not only affords a check on the stamps, but gives a useful record of letters sent to the mail; also if the postage is to be divided among different concerns, departments, or individuals, this book affords a ready means of doing so.

§ 235. **(82) Profit and Loss** (Cr. $75,405.10)

The amount shown by this account is, of course, the balance of Profit and Loss carried over from the last balance sheet. Some bookkeepers have a habit of making entries in this account from time to time during the fiscal period. This is not a good practice, the chief objection being that it affords an opportunity to hide entries or to distract notice therefrom. Any entry showing a loss or gain should be posted to some active account included in the "Earnings" or "Expense" schedule (§ 82). Entries to Profit and Loss during the fiscal period tend also to confuse an analysis of the trial balance.

§ 236. **(83) Profits** (Cr. $8,242.10)

The nature of this account and the method of keeping it are explained in § 82. As it represents profits already earned, the entire amount is transferred to the credit of Profit and Loss.

§ 237. **Prospect Park Accounts**

(84) Contracts, Dr. $1,158.98
(85) Gains, Cr. 1,576.00

(86) Purchase, Dr. 3,402.00
(87) Expense, Dr. 85.00

This group of accounts relates to subdivision property owned by the concern, the value of the unsold part being carried in the above Purchase account. At the time of making this purchase, the concern agreed that one T. Rinders (who participated in making the purchase) should have one-third of the profits as they were realized. His part of the account is treated more fully later under accounts Nos. 91, 92. The analysis of the sub-ledger shows that the open contracts, on which the balances are \$1,158.98, cover 14 lots, which were originally sold for \$2,195 and which cost the concern \$63 each. From these figures, it is evident that the average selling price was about \$157, and the net profit \$94 per lot.

With these facts, the unearned profit is as follows:

$$\frac{\$1,159}{\$2,195} \times 14 \times \$94 = \$694.87$$

If we deduct this amount from the balance of the Gains account (\$1,576), it is found that the earned profits are \$881.13, of which two-thirds (\$587.42) is credited to Profit and Loss; one-third (\$293.71) is credited to account No. 91 (Rinders, T.). \$694.87 remains in the Reserve Profits. The Expense account is carried to the debit of Profit and Loss. The Purchase account is verified by ascertaining that there remained unsold 54 lots, which, at \$63 each, amount to \$3,402.

§ 238. **(88) Real Estate** (Dr. \$473,130.13)

This account represents (as explained in §64) the actual cost of all real estate owned by the concern, except such subdivision tracts as are carried in separate accounts as for example, "Prospect Park Purchase." In making up the

balance sheet, a schedule of this real estate should be prepared giving the book number of each piece, sufficient description to identify it, and the value at which it is carried on the books. It is to be noted that the amount shown in the trial balance.............................. $473,130.13
is reduced in the balance sheet by the following items:

Brick-yard Royalties (account No. 6)	$1,300.00	
Stumpage (account No. 107)....	6,250.00	7,550.00
Leaving a balance in Real Estate of........		$465,580.13

§ 239. (89) **Rent Account** (Cr. $5,780)

The Rent account is described in Chapter XIV. The balance here shown represents the rents collected during the period from properties owned by the concern, and is therefore to be credited to Profit and Loss.

§ 240. (90) **Repairs** (Dr. $1,245.60)

This is an offset account to account No. 89, and represents the total amount spent by the concern on repairs to its property during the period. The total amount is charged to Profit and Loss. It is the practice of some offices to carry the rent and repairs in one account in the ledger. The balance of such account will therefore show the net rents collected. Experience has shown, however, that it is advantageous to carry these accounts separately, as the monthly trial balance will then exhibit the exact amount collected and the exact amount spent. These separate amounts are much more important than is the difference between them, and the latter figure can very readily be obtained when the separate balances are shown.

§ 241. **(91) Rinders, T.** (Dr. $280)

(92) Rinders, T., Reserve (Cr. $525.33)

These accounts are opened in connection with the Prospect Park property, accounts Nos. 84 to 87. As stated, Mr. Rinders is to be credited with one-third of the profits as the concern makes them. It is shown above that the average selling price was $157 and yielded an average gross profit of $94. The form of journal entry bringing sales of this property on the books, is as follows:

Prospect Park Contracts	$157.00	
To Prospect Park Purchase		$63.00
" " " Gains		62.67
" Rinders, T., Reserve		31.33

It will be seen that, by opening this Rinders' reserve account, there is shown a liability of the concern for the portion of the profits due him. Such entries had been made in the past, and at the last closing of the books one-third of the profits earned had been debited to this account, leaving $525.33 still unearned. There is now charged to this account the amount already shown as Rinders' share of the unearned profits ($293.71), which is brought in by the following entry:

Prospect Park Gains	$293.71	
To Rinders, T.		$293.71
For amount of unearned profits to date.		

This entry will change the balance of account No. 91 into a credit account of $13.71, which is carried into "Accounts Payable" column.

The principle of the above account is simple: The reserve account is credited with one-third of the profits as each sale is made, and is debited with the same proportion of the profits as they are earned. The balance, therefore,

shows a liability to Mr. Rinders which is contingent upon the contracts being carried out. As these profits are realized, Rinders' personal account is credited with "Profits Earned" and debited with the sundry cash advances made to him from time to time; the balance thus shows the cash due or excess payment made him. If instead of merely an interest in the profits, Rinders had also had an interest in the title of the land, the procedure would have been somewhat different; e.g., if "Real Estate" showed the full value of the lot, it would be necessary to open another credit account for Rinders as owner, crediting him with his interest, and entries regarding the profits would probably be similar to those indicated above.

§ 242. (93) Robinson, J., Trustee (Cr. $210,418.52)

This is one of the various trust accounts so often found on the books of real estate concerns. In this particular case the concern had acquired a large number of properties, assuming the mortgages outstanding against them — many of which were overdue. Mr. Robinson entered into an agreement with the concern that, in order to facilitate the financing of the concern, he would buy certain of these mortgages at their face value with interest to the date of his purchase, and would treat the total of the sum so spent as one account, on which he would expect 6% interest, payable half-yearly. All these mortgages had been entered in the mortgages payable ledger as having been assumed by the concern, and a notation was made on the account for each mortgage bought by Mr. Robinson of the fact that it was assigned to him, a journal entry being made as follows:

Mortgages Payable........................	$......	
Mortgage Interest Payable..................	......	
To J. Robinson, Trustee...............		$......

These remarks are, of course, applicable only to this particular form of trusteeship. Another common form is where a trustee advances a certain amount of money, which is credited to him and which is to be repaid out of the proceeds of the sale of certain lands. In such cases he should be credited with the amounts advanced, and it is usually well to open two accounts somewhat similar to Nos. 91 and 92, in one of which the trustee receives credit for the whole amount, and in the other he is credited with the amounts as they become payable to him and is charged with the cash payments made on account thereof, the balance from this latter account being transferred periodically to the first account.

§ 243. (94) Salaries (Dr. $23,805)
(106) Stationery and Printing (Dr. $472)

These accounts speak for themselves, and the entire balance in each case is carried direct to the debit of Profit and Loss.

§ 244. South Bay Accounts

(95)	Farm Contracts,	Dr.	$212,814.00
(96)	" Gains,	Cr.	239,657.65
(97)	" Purchase,	Dr.	95,580.00
(98)	Villa Contracts,	Dr.	32,850.00
(99)	" Gains,	Cr.	32,640.00
(100)	" Purchase,	Dr.	29,550.00
(101)	Front Purchase,	Dr.	19,560.00
(102)	Expense,	Dr.	32,805.00
(103)	Commissions,	Dr.	4,750.00
(104)	Reserve,	Cr.	72,000.00

These accounts refer to a large tract of land purchased by the concern some years before, consisting of farming

country, a frontage along a main highway, and also a valuable water frontage. The tract was therefore divided into three distinct tracts, viz.:

1. South Bay Farms
2. Villa Sites
3. Water-Front

the original cost being divided *pro rata* on the basis of the respective areas. For two or three years considerable sums were spent for road-making, surveying, draining, and other improvements, and these, as representing physical improvements, had been added to the cost of the property up to the time of the last balance sheet. The total amount so expended was divided among the three subdivisions in proportion to the amount of work done on each tract.

On the other hand, the water-front was not developed in any way, although some improvements for making roads through it were added to the original cost. As the final improvement of this tract was likely to require a great deal of expensive work, such as bulkheading, and as the profits from the South Bay tract a year ago had been considerable, $72,000 was taken from the South Bay profits and held in reserve for future improvements of the water-front, none of this latter having been sold.

The contract accounts are carried into the "Contracts" column, and the three purchase accounts are carried into the "Real Estate" column.

The Expense account ($32,805) was considered carefully and, as the owners felt that the property was now fairly well established, it was decided that about one-third ($11,000) should be charged direct to Profit and Loss and that the remaining $21,805 should be distributed as follows:

To Farms Purchase...........	$12,000
" Villa Site Purchase........	6,000
" Water-Front..............	3,805

The entire "Commissions" account (No. 103) was charged to Profit and Loss.

The Farms "Gains" results were arrived at as follows:

The open contracts covered 699 farms, which had yielded an average profit of \$392.23, the total original sales having been \$344,069. These figures showed an unearned profit of \$167,269 (which amount is retained in the balance sheet) and earned profits of \$72,388.65.

The Villa contracts show that the open contracts included 221 lots, which had yielded originally \$34,196, the original sales having been \$40,671. These give the following figures:

$$\frac{\$32{,}850}{\$40{,}671} \times \$34{,}196 = \$27{,}620.14$$

which is kept in the reserve profits, leaving \$5,019.86 to be carried to Profit and Loss.

§ 245. (105) Sperry, J. M. (Dr. \$422)

These are advances made to a traveling agent, and can be charged into Accounts Receivable.

§ 246. (107) Stumpage (Cr. \$6,250)

This account represents various sums collected during the preceding period as stumpage on timber lands owned by the concern, each item being credited on the real estate ledger to the particular tract involved. The total amount is now credited to Real Estate as being a reduction in the cost of the land. If the value of the land had been divided as indicated in § 99, these collections would have been so credited until they equalled the book value of the stumpage, all amounts in excess thereof being credited to Profits account.

§ 247. (108) **Suspense** (Dr. $750)

The uses to which a suspense account can properly be put are many, and it is usually necessary to have such an account on the books. In this particular instance the main office had paid a draft for $750 made by the sub-office just before the closing of the books, and the exact disposition thereof had not been ascertained.

§ 248. (109) **Taxes** (Dr. $398.63)

This account is carried direct to the debit of Profit and Loss, as it represents taxes for a past period.

§ 249. (110) **Mortgage Taxes** (Dr. $308.15)

This represents taxes paid for mortgagors by the concern, and is carried among the assets on the balance sheet.

§ 250. **Torbay Heights Accounts**

(111)	Contracts,	Dr.	$11,283.00
(112)	Purchase,	Cr.	4,450.00
(113)	Gains,	Cr.	5,220.00
(114)	Townley, J. R.,	Cr.	470.00

This is a small subdivision property which is handled on a selling contract, the owner receiving $166.66 for each lot; 50% of gross receipts being paid to him from month to month, the concern paying all expenses and the profits on cancellations being divided equally between the owner and the concern. In this case, Purchase account is credited with $166 on each lot shown in the usual way, and each month a journal entry is made in the following form:

Torbay Heights Purchase....................	$......	
To Torbay Heights, J. R. Townley......		$......
For 50% of the gross receipts during the month of .... on this property.		

Mr. Townley's account is charged with cash payments as they are made to him. The balance of the Purchase account is therefore a liability contingent on the completion of the contracts, while Townley's account shows the actual liability existing at any time, and which at the date of the balance sheet amounted to \$470, and is carried in the "Accounts Payable" column.

There is one particular complication in this account which does not appear upon its face. Among the open contracts several are included which are really dead, but which the concern has not cared to cancel inasmuch as the terms of the original agreement have expired and they hope to find some other purchasers and thus realize their profit.

The analysis of the sub-ledger shows that the balance of the open contracts represents in all 60 lots, the average selling price being \$369.16, and the average profit \$202.50. The unearned profit is therefore as follows:

$$\frac{\$11{,}283}{\$22{,}150} \times 60 \times \$202.50 = \$6{,}189.09$$

It will be noticed that this is a larger amount than that shown in the Gains account, but, in view of the fact that there is a good prospect of the concern's re-selling the cancelled contracts, this amount is allowed to remain in the reserve, no part of it being carried to Gains.

§ 251. (115) **Treasury Stock** (Dr. \$22,000)

It had been the practice of this particular concern during past years to accept its own capital stock in payment for its real estate, and in this way it has recovered \$22,000 of the stock originally issued. This amount is therefore carried in its own account and appears on the balance sheet, where it is deducted from the original issue of the stock.

§ 252. (116) Cash—Superintendent (Dr. $120)

This account represents an amount of money for current expenses, placed in the hands of the superintendent of one of the subdivisions, the account on the general ledger remaining unchanged from month to month. Such an account is best kept in a manner similar to that used for petty cash (§ 14), except that in this case there are likely to be sundry receipts from other sources, such as the sale of wood or old lumber, etc. The most convenient form of record is the superintendent's cash book, described in § 15.

§ 253. (117) Cash in Bank (Dr. $7,990.40)

This account represents balances in several banks, which have, of course, been verified by comparison of the cash book with the respective bank pass-books. As no cash account is carried in the ledger (§ 13), these balances are brought direct from the cash book to the trial balance.

§ 254. Preparation of Balance Sheet

Having now considered and classified all the items appearing on the trial balance, the preparation of the balance sheet is a simple matter, provided its nature and purposes are clearly understood. The balance sheet may be said to consist of the figures obtained above, arranged in a logical manner. There are, however, certain points in regard to this arrangement which require some discussion and which will therefore be taken up in Chapter XXVIII.

CHAPTER XXVII

THE TRIAL BALANCE AND MONTHLY STATEMENTS

§ 255. The Purpose of a Monthly Trial Balance

All good bookkeepers take off frequent trial balances, and many hours are sometimes occupied in the search for small errors in posting, adding, or balancing. When this trial balance is completed, what does it prove? There has always been an impression, denied in words but admitted in practice, that it proves the books to be correct. It goes without saying that such proof cannot be so easily secured. It is, in fact, only obtained by means of a complete audit, and, very often, a still further examination and analysis is required.

The proof afforded by a trial balance is merely negative. If the debits do not equal the credits, it is proof that one or more errors exist. Their equality may be said to prove nothing, for there could be errors without number and, provided the total of the errors on each side were equal, the books would still be "in balance." It may therefore be said that the usual form of trial balance conveys comparatively little information; it shows a series of balances or results, but considerable further examination and information are required before the true meaning of these results can be obtained.

§ 256. The Monthly Statement

These acknowledged facts show that a large amount of labor is expended to obtain something of comparatively

small value, or, rather, something of which little practical use is made. This condition prevails in so many well-conducted offices as to indicate an ignorance of the proper use to be made of the figures furnished in a trial balance, and hence a waste of labor in this connection—labor which brings together quantities of material from which valuable and helpful statements might be constructed, but which is left unused.

The remedy for this condition may be found in the form of statement described in the present chapter, which is now coming into general use. It calls for no more labor than the trial balance but yields results which are often invaluable. Such a statement differs from a mere trial balance in two essentials:

1. The accounts, instead of forming one long list in the order of ledger folios, are classified and grouped into "profit-yielding" accounts, "sales" accounts, "expense" accounts, etc., each particular group of accounts carrying its own totals.

2. In addition to the balance of each account on the date of the statement, there are shown in two separate columns the total debits and the total credits which have been posted to each account during the month, or other period, covered by the statement.

The grouping enables the management to get a systematic and comprehensive idea of the entire business, while the entry of debits and credits shows in brief the business transacted since the last trial balance.

§ 257. Advantages of the Monthly Statement

Inasmuch as such a statement shows all ledger balances, it is a trial balance; it is also much more, as will be seen if we consider a few of the accounts shown in the statement on pages 267 to 270.

"Advertising" shows a debit balance of $12,114.02. The monthly columns show that of this amount $783.03 has been spent during the last month.

"Real Estate" with a debit balance of $483,130.13 is seen to have increased (probably owing to purchases or cancellations) by $855, and has been decreased (probably by sales) by $148.52. In such a case, a reference to the ledger will quickly enable one to ascertain the exact cause.

"Bills payable" shows that there are outstanding notes amounting to $81,340; that during the month $11,889.44 has been paid off and $10,000 has been borrowed.

"Contracts" account shows that new contracts to the amount of $8,539.55 have been made during the month, while $7,229.04 has been credited by cash allowances and cancellations.

By grouping the accounts, we learn that our total net expenses for the month have been $7,832.57 ($7,880.12 — $47.55) and, for the period, $84,682.38.

The value of such information presented clearly and regularly to a management, is so obvious that further comment is unnecessary.

§ 258. Method of Preparing the Monthly Statement.

On pages 267 to 271 the same trial balance is shown as was analyzed in Chapters XXV and XXVI. To the figures there shown have been added the total debit and total credit appearing in each account during the last preceding month. These totals are quickly obtained if the form of general ledger shown in Form 7 (§ 17) is used. The accounts are grouped as follows:

A. General Accounts
B. Expense
C. Earnings
D. Real Estate

E. Selling Contracts
F. Contracts
G. Profits in Reserve
H. Summary
etc., etc.

An examination of each group of accounts shown in the statement on pages 267 to 271, will show that it contains all entries relating to that class, and the totals give the total of such transactions. The grand total of the summary agrees with the total of the trial balance given on pages 222 to 225. In practice, the bookkeeper usually has a number of blank forms typed in manifold, each one of these manifolded forms containing all the accounts in one classification. When this is done the time required to take off the monthly statement is not appreciably greater than that required for the regular trial balance.

It is often said by managers of real estate concerns interested in time sales, that it is impossible to show the amount actually earned in any one year, especially if that year be an early one in the history of the concern while the expenses and development are still increasing and when few sales have been completed. With monthly statements such as are outlined above, and with proper treatment of profits from time sales, it is possible to approximate very closely not only the earnings of a year, but the earnings of each month.

§ 259. Determination of Earned Profits.

Let us consider the methods by which such results may be obtained. It will be seen that all general expenses are included under Group B. The figures are actual and require no explanation. They include current expenses in connection with subdivisions, e.g., Parkville expenses; while those expenses pertaining to improving and developing

specific tracts are included in Group D (Real Estate), and regarded as an increase of investment. It is evident that discretion must be used in such classification. The value of these monthly estimates must, in fact, depend largely on the judgment of those who prepare them. They are not intended for publication, nor even for the stockholders, but are prepared for the personal guidance of the executive officers. Conservative lines should therefore be followed in their construction, or otherwise, they may, instead of guiding, actually mislead and deceive. Probably the best results can be obtained if these statements are prepared by the auditor of the concern, whose training and independent viewpoint give him the advantage over the bookkeeper for work of this kind.

Having ascertained the monthly expenses, how are the profits to be determined?

Group C gives the definite earnings which appear on the face of the ledger and which require no further calculation. Other profits consist of a certain proportion of the cash collected from time sales of all classes, and the determination of these profits calls for the exercise of judgment and for some calculation.

It has been shown in § 144 that the amount of the profit earned depends solely upon the amount of cash collected. This amount can be determined from the ledger or the columnar cash book. The figures of Group J (§ 270) give these receipts for the month covered by the example.

Group K (§ 271) is framed on the experience of a number of years, during which it has been found that 46% of the cash collections on time sales consist of earned profits. This percentage will, of course, vary with each business, and will reach as high as 46% only when a large proportion of the sales consists of development properties. In order to be quite on the safe side, only 45% of the cash

receipts shown in Group J is taken, and with this figure Group K gives very closely the actual profit earned in the month. If the special ledger (Form 11, § 20, or Form 15, § 23) is used, this figure, instead of being estimated, will be determined accurately.

In Group I are shown all sales made during the month, with the gains thereon. This is not used in ascertaining earned profits, but is useful as showing the business done; e.g., a comparison of the net amount of new sales with the cash collections in Group J will show whether the business is growing or diminishing; while a comparison of these figures month by month shows whether or not a satisfactory standard is being maintained.

There are two other methods of calculating the proportion of cash receipts representing earned profits, as follows:

1. A comparison of the amount of outstanding contracts of any one class with the gains thereon will show the ratio between collections and earned profits. For example:

Eureka Gardens	Contracts	= $2,460
" "	Gains	= $1,330

The fraction $\frac{1{,}330 \times 100}{2{,}460}$ represents the number of cents in each dollar collected, which is earned profit.

The collections on each subdivision may, if desired, be treated in this way, in which event Group F could be made to include a column showing the ratio applicable in each case; and the earned profits and their total could be substituted for figure $8,115.84 in Group K (§ 271).

In the case of profits from general contracts and from mortgages receivable, the profits as a whole are fairly uniform from year to year; and as the general Gain on Sales account is composed of gains from these two sources, very

close figures can be obtained by a method similar to that described above.

2. In the event that the subdivision sub-ledger of Form 15 (§ 23) is kept, no calculation is necessary beyond mere addition or subtraction; for if the totals of the "Reserve Realized" columns be taken off on an adding machine at the end of each month, the difference between the totals for any two months gives at once the amount of profits earned or realized.

§ 260. Comparison of Monthly Statements

While each of these monthly statements is of value *per se,* their value as a whole increases each month on account of the ready means they afford of observing the fluctuations of the business and of making monthly comparisons. If made honestly, these monthly statements give results which may be relied upon. It may be argued, especially by those not accustomed to use them, that they are in the nature of estimates. This objection, however, does not affect their value for comparative purposes; for if the statements for a series of months are drawn on the same basis, it is evident they must show correctly the comparison between the business transacted in the respective months.

By means of loose leaves in a "ring" binder, it is not difficult to file these monthly statements in such a manner as to afford a ready means of comparison, and also to dispense with the monthly writing of the headings of the various accounts. Under this plan the accounts are typed on the right-hand side of sheets of the full width (say 8 × 14 inches) and the monthly figures may be written on sheets 5 × 14 inches, containing four money columns and horizontal ruling to correspond with the full sheets, the typing on which will be visible at all times.

§ 261. A. General Accounts

Month's Business		Acct. Nos.	Accounts	Balances	
Dr.	*Cr.*			*Dr.*	*Cr.*
....	....	1	Accounts Payable	....	$3,420.00
....	$400.00	3	Automobiles	$1,138.02	....
$11,889.44	10,000.00	4	Bills Payable	....	81,340.00
....	....	5	Bills Receivable	1,250.00	....
....	....	11	Capital Stock	....	305,000.00
899.00	....	16	Contracts Payable	....	8,002,40
50.00	....	19	Dividends Unpaid	....	520.00
....	....	26	Expense, Mortgage	548.50	....
79.85	53.71	35	Handbook	985.00	....
80.00	....	36	Hilton, A. B.	130.00	....
....	....	39	Insurance, Mortgage	283.75	....
....	807.00	43	Int. Overdue Mtge. Pay.	....	120.00
420.00	....	45	" " " Rec.	1,178.10	....
....	....	47	Judgments	925.00	....
125.00	....	66	Manning, R.	....	212.00
....	....	67	Mortgages Defic'y Acct.	....	2,000.00
2,225.00	8,000.00	68	" Payable	....	257,422.30
....	239.33	69	" Receivable	45,000.00	....
....	....	70	" in Settlement	5,250.00	....
32.00	....	71	Office Furniture	3,200.00	....
....	....	72	" Fixtures	3,156.00	....
....	....	80	Petty Cash	75.00	....
....	....	82	Profit and Loss	....	75,405.10
....	....	91	Rinders, T.	280.00	....
....	....	92	" " Reserve	....	525.33
5,462.00	7,460.00	93	Robinson, J., Trustee	....	210,418.52
....	....	104	So. Bay Reserve	....	72,000.00
252.00	....	105	Sperry, J. M.	422.00	....
....	....	108	Suspense	750.00	....
12.40	....	110	Taxes, Mortgage	308.15	....
....	224.00	114	Townley, J. R.	....	470.00
....	....	115	Treasury Stock	22,000.00	....
8,111.40	9,895.27	117	Cash	8,110.40	....
$29,638.09	$37,079.31			$94,989.92	$1,016,855.65

§ 262. B. Expense

Month's Business Dr.	Month's Business Cr.	Acct. Nos.	Accounts	Balances Dr.	Balances Cr.
$783.03	....	2	Advertising	$12,114.02	....
....	....	12	Charity	37.00	....
164.50	....	14	Commissions Paid	8,325.00	....
70.00	$20.00	18	Directors' Meetings	185.00	....
1,316.97	....	23	Eureka Gardens Expense	40.00	....
915.46	15.00	24	Expense, General	12,440.00	....
84.60	9.50	25	" Legal	1,522.00	....
22.00	....	38	Insurance	711.28	....
436.53	....	41	Interest Paid	4,640.00	....
807.00	....	42	" Mortgage Payable	11,120.00	....
28.00	....	53	Kingslake Commissions	461.40	....
60.00	....	59	Ladore Commissions	....	$1,580.00
175.00	....	61	Life Insurance	2,120.00	....
112.46	....	65	Malvern Hill Expense	7.25	....
35.90	....	78	Parkville Expense	783.20	....
75.00	....	79	" Commissions	275.00	....
50.96	....	81	Postage	725.00	....
240.00	....	87	Prospect Park Expense	85.00	....
146.95	....	90	Repairs	1,245.60	....
1,888.70	....	94	Salaries	23,805.00	....
195.00	....	103	So. Bay Commissions	4,750.00	....
133.85	....	106	Stationery and Printing	472.00	....
138.21	3.05	109	Taxes	398.63	....
$7,880.12	$47.55			$86,262.38	$1,580.00

§ 263. C. Earnings

Month's Business Dr.	Month's Business Cr.	Acct. Nos.	Accounts	Balances Dr.	Balances Cr.
....	$322.00	10	Cancellation Profits	....	$3,400.00
....	130.00	13	Commissions Earned	....	5,220.00
....	39.07	40	Interest Earned	....	9,840.00
....	420.00	44	" Mortgage Receivable	....	2,400.00
....	....	83	Profits	....	8,242.10
$168.75	804.00	89	Rents	....	5,780.00
$168.75	$1,715.07			....	$34,882.10

§ 264. D. Real Estate

Month's Business		Acct. Nos.	Accounts	Balances	
Dr.	*Cr.*			*Dr.*	*Cr.*
....	$105.00	6	Brickyard Royalties	....	$1,300.00
$540.00	....	7	Building, Green	$1,250.00	....
....	....	8	" Black	72.50	....
416.00	....	9	" Brown	....	325.00
8,640.00	....	17	Dawes Purchase	8,640.00	....
680.00	....	30	Fairmount Expense	5,795.00	....
....	....	33	Grandville Purchase	5,378.00	....
173.75	40.00	49	Kingslake Purchase	1,272.11	....
....	....	51	" Expense	83,370.60	....
....	....	52	" Lots	751.90	....
....	200.00	56	Ladore Purchase	38,840.00	....
240.00	....	58	" Expense	4,229.04	....
....	90.00	60	" Town Lots	10,560.00	....
....	489.40	63	Malvern Hill Purchase	34,057.00	....
....	380.00	73	Options Granted	....	5,200.00
400.00	....	74	" Held	3,400.00	....
....	....	86	Prospect Park Purchase	3,402.00	....
855.00	148.52	88	Real Estate	483,130.13	....
....	1,223.20	97	So. Bay Farm Purchase	95,580.00	....
....	28.02	100	" " Villa "	29,550.00	....
....	....	101	" " Front "	19,560.00	....
....	....	102	" " Expense	32,805.00	....
....	682.00	107	Stumpage	....	6,250.00
$11,944.75	$3,386.14			$861,643.28	$13,075.00

§ 265. E. Selling Contracts

Month's Business		Acct. Nos.	Accounts	Balances	
Dr.	*Cr.*			*Dr.*	*Cr.*
....	....	21	Eureka Gardens Purchase	....	$1,375.00
....	....	28	Fairmount Purchase	....	1,200.00
....	....	76	Parkville "	....	8,725.00
$195.62	....	112	Torbay Heights Purchase	....	4,450.00
$195.62	....			....	$15,750.00

§ 266. F. Contracts

Month's Business		Acct. Nos.	Accounts	Balances	
Dr.	*Cr.*			*Dr.*	*Cr.*
$8,539.55	$7,229.04	15	Contracts—General	$165,770.00	....
....	80.00	20	Eureka Gardens	2,460.00	....
....	100.00	27	Fairmount	1,915.00	....
....	85.70	32	Grandville	1,827.42	....
3,420.30	2,166.55	48	Kingslake	61,799.88	....
550.00	630.00	55	Ladore	30,506.00	....
4,175.00	1,835.70	62	Malvern Hill	37,467.00	....
....	549.55	75	Parkville	18,842.00	....
....	337.50	84	Prospect Park	1,158.98	....
8,600.00	4,840.45	95	So. Bay Farms	212,814.00	....
150.00	719.75	98	" " Villas	32,850.00	....
....	391.25	111	Torbay Heights	11,283.00	....
$25,434.85	$18,965.49			$578,693.28	....

§ 267. G. Profits in Reserve

Month's Business		Acct. Nos.	Accounts	Balances	
Dr.	*Cr.*			*Dr.*	*Cr.*
....	....	22	Eureka Gardens Gains	....	$1,330.0
....	....	29	Fairmount Gains	....	1,200.0
$290.00	$3,140.00	31	Gain on Sales	....	88,045.8
....	....	34	Grandville Gains	....	1,056.8
....	....	46	Interest Unearned	....	3,529.8
290.60	2,260.00	50	Kingslake Gains	....	106,902.0
....	350.00	57	Ladore Gains	....	25,470.0
....	3,685.60	64	Malvern Hill Gains	....	23,022.0
....	....	77	Parkville Gains	....	9,796.0
183.18	....	85	Prospect Park Gains	....	1,576.0
....	5,376.80	96	So. Bay Farms Gains	....	239,657.6
101.98	121.98	99	" " Villas Gains	....	32,640.0
....	....	113	Torbay Heights Gains	....	5,220.0
$865.76	$14,934.38			....	$539,446.1

§ 268. H. Summary

Month's Business			Balances	
Dr.	*Cr.*		*Dr.*	*Cr.*
$29,638.09	$37,079.31	General Accounts	$94,989.92	$1,016,855.65
7,880.12	47.55	Expense	86,262.38	1,580.00
168.75	1,715.07	Earnings	....	34,882.10
11,944.75	3,386.14	Real Estate	861,643.28	13,075.00
195.62	....	Selling Contracts	....	15,750.00
25,434.85	18,965.49	Contracts	578,693.28	....
865.76	14,934.38	Profits in Reserve	....	539,446.11
$76,127.94	$76,127.94		$1,621,588.86	$1,621,588.86

§ 269. I. Sales and Cancellations

Sales

	New Contracts	Profits
Contracts:		
General	$8,539.55	$3,140.00
Kingslake	3,420.30	2,260.00
Ladore	550.00	350.00
Malvern Hill................................	4,175.00	3,685.60
South Bay Farms	8,600.00	5,376.80
" " Villas	150.00	121.98
	$25,434.85	$14,934.38

Cancellations

Contracts:		
General	$400.00	$290.00
Kingslake	340.30	290.60
South Bay Villas............................	190.00	101.98
	$930.30	$682.58

§ 270. J. Cash Receipts for the Month

Contracts:		
General	$7,229.04	
Cancelled	400.00	$6,829.04
Eureka Gardens		80.00
Fairmount		100.00
Grandville		85.70
Kingslake	$2,166.55	
Cancelled	340.30	1,826.25
Ladore		630.00
Malvern Hill		1,835.70
Parkville		549.55
Prospect Park		337.50
South Bay Farms		4,840.45
" " Villas	$719.75	
Cancelled	190.00	529.75
Torbay Heights		391.25
		$18,035.19

§ 271. K. Earned Profits—Cash Receipts

It has been shown in § 144 that earned profits vary directly with, and depend solely upon, the cash receipts. An analysis of the accounts of the concern for the previous year shows that the earned profits on contracts were taken as 45% of the cash receipts from those contracts.

The cash collections on contracts shown above are		$18,035.19
45% of this is		$8,115.84
To this we add the earnings in "C"	$1,715.07	
	168.75	1,546.32
Making total earnings		$9,662.16
The expenses per "B" are	$7,880.12	
	47.55	7,832.57
Leaving net earnings for the month		$1,829.59

In the above examples it will be noticed that taxes, insurance, and interest are included with the other expenses. In some instances, where these amounts can be definitely stated for the whole year, it is better to eliminate them from the current expense account, transferring them to Group A (General Accounts); and then, on Group K, deduct one-twelfth of the annual amount of each of these items. The wisdom of this course depends, of course, upon individual circumstances.

CHAPTER XXVIII

THE BALANCE SHEET, THE ANNUAL REPORT, AND SCHEDULES

§ 272. Nature of the Balance Sheet

The term "balance sheet" is the sole reminder in modern accountancy of what in former days was regarded as an essential function, viz., that of "balancing" the accounts. At the end of a fiscal period all the accounts remaining on the ledger, after closing the profit and loss account, were entered in the balancing account, and from it were opened all the accounts for the succeeding period. In other words, all accounts went in on one side and came out on the other unaltered by a dot.

Of this practice only the name survives. It is mentioned here to remind the reader that the word "balance" has two entirely distinct meanings in the expressions "balance sheet" and "trial balance," and to indicate the cause for that distinction.

As we have seen, the trial balance is a list of ledger balances. The balance sheet is a statement of the accounts formerly passed through the balancing account. In practice today, however, the balance sheet is not, strictly speaking, a list of balances, but a statement compiled after all the nominal accounts have been brought together in a profit and loss account, or revenue account, and after all inventories have been taken. The accounts still remaining on the ledger show the "unfinished business" of the concern. These balances are then put in the form of a statement of assets and liabilities at a given moment, together with

such reserve, surplus, or profit and loss accounts as bring the two sides of the statement to an equality.

§ 273. Continental and English Forms of Balance Sheet

The general form of balance sheet known as the Continental form (or, in Scotland, as the Scotch form), places the assets on the left-hand and the liabilities on the right. The English form reverses this, but is seldom used in this country except in statements for use in England. The difference between the two forms may possibly be traced back to the balancing account, as it has been suggested that under the English method the accounts are shown as taken *into* the balancing account, while the Continental form shows them after they have been taken *out* of that account. It is more probable that the English practice has been brought about solely by the income tax acts of Parliament, which convey the impression that the forms of returns prescribed were prepared by those who were authorities on some subject other than that of accountancy.

Inasmuch as the Continental form of balance sheet is in general use throughout the United States, it is followed in this volume, especially as it appears more logical and more convenient to show any one class of accounts on the same side of the balance sheet and the trial balance.

§ 274. Arrangement of Balance Sheet Items

The balance sheets of transportation companies, banks, trust companies, insurance companies, etc., are regulated by statute or by custom, and need not be considered here. In all balance sheets, however, it is desirable that some uniformity of purpose, if not of arrangement, be observed.

Many different orders of procedure have been laid down for the items of the balance sheet and, unfortunately, there is no Herald's College clothed with authority to decide

which shall prevail. The form given on pages 278, 279 is based upon those principles which appear to the writer to be the most strongly founded.

Regarding the assets, which, as a rule, are of a more varied nature than the liabilities, the weight of practice prescribes that the arrangement be based either upon the importance or the liquidity of the various items.

If we arrange in order of liquidity, "Cash" will head the list; yet there are few cases in which the cash appearing on the balance sheet is important as compared with other items. Similar conditions are likely to exist as to other quick assets, as, for example, "Bills Receivable," the final result being that if the items are marshalled in order of liquidity, the more important items may be found scattered throughout the statement instead of being brought together. To obviate this, the order of importance is preferable and is here adopted.

In doing so, however, it must not be forgotten that the quick assets should be clearly shown by themselves, for it is frequently in them that the banker may have his chief or only interest. These can be shown as indicated on pages 278, 279, without interfering in any way with the main arrangement.

§ 275. Schedules Accompanying a Balance Sheet

It is evident that if all items were shown on the balance sheet the very purpose of that sheet would be defeated, for its conciseness would be lost. For this reason totals are used, the details composing these totals being shown in accompanying schedules, which must therefore be regarded as part of the balance sheet. Such schedules include:

A. Real Estate. The items of this schedule are taken from the property ledger and show book number, description, and book value (or cost).

B. Mortgages Receivable. The items of this schedule are taken from the sub-ledger, and show the book number of each mortgage, and the name, due date, rate of interest, amount, and book number of the property concerned. This statement may also show in a separate column the total charges of all kinds standing against each mortgage and shown on the balance sheet given on pages 278 and 279.

C. Contracts Outstanding. This schedule is a list of the balances of the sub-ledger. It may be well to show the book number of each piece of property involved, and any overdue items may be noted thereon.

D. Bills Receivable. This schedule is taken from the ledger or the bills receivable book, showing name of make, due date, and amount.

E. Sundry Debtors. This schedule comprises all those debtors appearing in the general ledger and in the balance sheet; names and amounts should be given, together with a brief description of any items calling for special remark.

F. Cash. This schedule consists of a list of bank balances when accounts are kept with several banks. As a rule these details are shown on the balance sheet itself rather than on a special sheet.

G. Mortgages Payable

H. Contracts Payable

I. Bills Payable

J. Sundry Creditors

The schedules G–J should show items similar to those in schedules B, C, D, and E.

§ 276. Form of Balance Sheet

The balance sheet of the Alpha Land Company is shown on the following pages. This is given complete, but is followed by the same balance sheet in condensed form.

THE ALPHA
BALANCE SHEET—

Assets	Sch.			
Real Estate, at cost	A		$779,356.89	
Less Options Granted			5,200.00	$774,156.89
Mortgages Receivable, Principal	B		$45,000.00	
Mortgage Expenses	B	$548.50		
" Insurance	B	283.75		
" Interest	B	1,178.10		
" Taxes	B	308.15	2,318.50	
Total, Good Mortgages Receivable			$47,318.50	
Mortgages in Settlement		$5,250.00		
Less Mortgage Deficiency Account		2,000.00	3,250.00	
Contracts Outstanding	C		568,433.33	
Total Time Sales Outstanding, Net				619,001.83
Bills Receivable	D		$1,175.00	
Sundry Debtors	E		1,477.00	2,652.00
Equipment:				
Automobiles			$738.02	
Office Furniture			2,720.00	
" Fixtures			2,682.60	6,140.62
Sundries:				
Suspense Account			$750.00	
Handbook			985.00	1,735.00
Cash:				
Petty Cash			$75.00	
Deposited with Bankers	F		8,110.40	8,185.40
				$1,411,871.74

LAND COMPANY
DECEMBER 31, 1916

Liabilities	Sch.			
Capital Stock Issued...........			$305,000.00	
(Authorized $500,000)				
Less Treasury Stock........			22,000.00	$283,000.00
Robinson, J., Trustee..........		$210,418.52		
Mortgages Payable, Principal..	G	257,422.30		
" " Interest ..		120.00		
Contracts Payable—unpaid purchase money on properties included in Real Estate Account	H	8,002.40		
Total "Real Estate" Liabilities..			$475,963.22	
Bills Payable..................	J	$81,340.00		
Sundry Creditors..............	K	695.71		
Unpaid Dividends.............		520.00		
Accounts Payable.............		3,420.00		
Total Current Liabilities.......			85,975.71	
Purchase Contingent Liability due only on completion of sales included in Time Sales Contract Account:				
Eureka Gardens...........		$1,195.00		
Fairmount		1,200.00		
Parkville		3,950.00		
Rinders, T.................		525.33		
Torbay Heights...........		4,450.00	11,320.33	
Total Liabilities, other than Capital Stock................				573,259.26
Total Liabilities...............				$856,259.26
Reserve and Undivided Profits:				
Uncompleted Bldgs., Brown.		$325.00		
Commissions, Ladore........		1,580.00		
Expenses, Ladore...........		2,500.00		
South Bay..................		72,000.00	$76,405.00	
Reserve Profits................	L	$361,790.37		
Less due Kingslake owner...		11,000.00	350,790.37	
Profit and Loss Account, balance brought forward.......		$75,405.10		
Profits for the period.........	M	53,012.01	128,417.11	
Total Reserve and Undivided Profits				555,612.48
				$1,411,871.74

THE ALPHA LAND COMPANY

CONDENSED BALANCE SHEET—DECEMBER 31, 1916

Assets		*Liabilities*	
Real Estate Unsold....	$774,156.89	Capital Stock Outstanding	$283,000.00
Mortgages and Contracts	619,001.83	Mortgages and Contracts Payable.......	475,963.22
Bills Receivable.......	1,175.00	Bills Payable..........	81,340.00
Equipment	6,140.62	Sundry Creditors.....	4,115.71
Sundry Debtors, etc....	3,212.00	Purchases (Contingent Liability)	11,320.33
Cash	8,185.40	Dividends Unpaid.....	520.00
		Total Liabilities.....	$856,259.26
		Reserve, Fees, Improvements and Taxes....	76,405.00
		Profits in Reserve.....	350,790.37
		Profit & Loss and Undivided Profits......	128,417.11
	$1,411,871.74		$1,411,871.74

It has been said above that a balance sheet is not strictly a collection of ledger balances, and several examples of the fact are found in the form on pages 278, 279. For example, the first item of "Real Estate" is reduced by the sum received for options, which must be treated as purchase money until the options expire. Other instances appear in "Mortgages in Settlement" and "Capital Stock"; and in each case it will be seen that a clearer statement is obtained by the methods followed than if the various items had been placed separately. It will also be seen that the sub-totals of the balance sheet show clearly on the one side the total real estate owned and the total unpaid balances on all time sales; while, on the other side, they show the capital stock liability, the current, the contingent, and the total liabilities.

§ 277. Schedules to Accompany Annual Report

We now come to another class of schedules, which, though accompanying a balance sheet, are not so much a part of it as of an annual report. The form of such a report must vary with the nature and size of the business, with various existing legal requirements (as is so frequently the case in reports of English corporations), and with the individuality of the person preparing it.

It goes without saying that a report must be truthful, but truth is many-sided and may be expressed in different ways. In describing the forms for an annual report, therefore, dogmatism as to details must be laid aside, and the following suggestions are made merely to indicate the general requirements of a complete report.

In considering this report it is assumed that the concern reporting is a corporation in which many stockholders are interested, and it is intended that the report shall be sufficiently complete to enable the officers to answer any legitimate questions which may be put at a stockholders' meeting. Apart from this, however, a complete tabulation of a year's results is of value on account of the minute examination of each account which it compels, and which often brings to light matters that have been omitted or overlooked. In addition, a complete report has value in succeeding years as a convenient reference for purposes of comparison; if well prepared, it almost obviates reference to the books themselves.

The basis of the report is, of course, the balance sheet and its accompanying schedules. The report should give any further explanations which may be advisable, should give prominence to points requiring attention, and perhaps contain suggestions for guidance in the future.

The schedules accompanying a report include such statements as the following:

Cash Receipts, classified by months and by sources.
Disbursements, classified by months and by distributions.
Sales, classified by months and by divisions; e.g., cash, mortgage, contract, etc.
Expense accounts of all kinds, analyzed by months.

These statements are particularly illuminating when, in addition, they compare the figures for the current year with those for preceding years.

The preparation of the report of the president or of the directors does not lie with the accounting department, still the report of that department should contain all such information as, in the judgment of the accountant, is necessary to exhibit clearly the business. The duty of an accountant to make suggestions depends almost entirely upon the nature of his engagement and the duties he has undertaken; these vary in the United States according to the wishes of the particular board or of the individual officer through whom the engagement is made.

CHAPTER XXIX

REAL ESTATE AUDITS

§ 278. Real Estate Inventories

Before entering upon the details of auditing real estate accounts, it is well to consider the points wherein such an audit differs from that of a mercantile or manufacturing concern. In a general way, the differences may be indicated by the one word "inventories."

The duties of auditors in connection with the inventories of the ordinary business concern are no safe guide in the audit of a real estate concern, for the reason that, as a rule, the manner of taking inventories is different. The accounts corresponding to the usual inventories are those which appear in the balance sheet under the heads of Real Estate, Mortgages, Contracts, etc.; and a real estate concern when preparing its balance sheet does not send out a stock clerk to list its holdings by actual count and measurement, but depends upon the records in the office itself.

§ 279. Verification of Real Estate Assets

In the last-named respect, a real estate audit resembles that of a bank or a trust company; and it is evident that any bank auditor would be guilty of grave dereliction of duty if he failed to satisfy himself by minute investigation that the securities and other assets (i.e., the inventories of the institution) were as represented.

An important difference exists, however, between the audit of real estate assets and the audit of the assets of a bank. The verification of real estate assets must not only

include proof that all the assets claimed are really held, but should also show that no such asset is used illegitimately.

Stress is laid upon this latter point for two reasons:

1. The customs prevailing in the handling and recording of real estate render the illegitimate use of assets unusually easy.
2. Past experience has shown that this point has been frequently overlooked by auditors and that such oversight has resulted in grave losses to clients.

The frauds possible under existing conditions may result from carelessness and ignorance, but arise chiefly from dishonesty on the part of those responsible; and, while it is not intended to attempt any catalogue of the frauds common or possible in real estate transactions, the illustrations cited in the present chapter will indicate certain dangers which exist.

In the case of financial securities, any change of ownership, and more especially any hypothecation of such securities, usually requires the documents themselves to be placed in the hands of the lender or of his representative. This condition does not apply to real estate. An owner pledging a piece of property in any way usually retains possession of the documents showing his title to the property. The possession of such papers does not therefore prove a clear title, as does usually the possession of a bond. Again, when mortgages are satisfied, a "satisfaction piece" is usually given, and it is by no means an unknown thing for the mortgagor not to insist upon the return of the original mortgage. For these and similar reasons, it is of the first importance that the auditor satisfy himself that all money received from or on account of real estate is properly shown on the cash book, mortgage books, and on the real estate ledger itself.

§ 280. Examination of Records

If further evidence of the nature and condition of titles is required, it is usually practicable to have the proper county or other official furnish periodical lists of all papers recorded with him in which the name of the concern appears. Such a list would enable an auditor to verify almost completely all transactions regarding the purchase and mortgaging of property. The word "almost" is inserted with intent, as, if fraud were deliberately planned, fictitious changes of ownership might be arranged in order to prevent the name of any mortgagor appearing on record twice. This possibility, however, can be met by having the lists prepared by an outside abstract company, and having them cover all entries relating to lands in which the concern is interested.

Contracts are frequently not recorded, and their verification is considered later in § 290.

§ 281. Mortgage Frauds

Another fraud frequently practiced is the multiplying of mortgages on the same piece of property. This can be effectively guarded against by proper entries on the real estate ledger, by the record of each mortgage, and by reference to the periodical lists of the above-mentioned recording officials.

Cases have occurred in which books, records, and accounts appeared to be in perfect order, and auditors therefore granted favorable certificates, which were, however, based solely on the *financial* records and an accompanying certificate. For each loan included in the assets there was a mortgage technically correct in all details, but it was not considered necessary to bring the financial transactions on to the tract books or plat books, and, in the case of a large business with some hundreds of mortgages outstanding,

the auditors failed to discover that certain lands were covered by one, two, or even three mortgages.

§ 282. Details of an Audit

The complete audit of such a concern as is represented in the typical trial balance shown in Chapter XXV would include a verification of the following classes of accounts:

Cash Receipts
Cash Disbursements
Real Estate Owned
Mortgages Receivable, Principal, and Interest
Contracts
Equipment
Sundry Debtors
Capital Stock
Treasury Stock
Trustees' Accounts
Mortgages Payable, Principal, and Interest
Contracts Payable
Bills Payable
Sundry Creditors
Purchase Accounts
Unpaid Dividends
Rents
Reserve Accounts
Reserve Profits
Profit and Loss Account
Branch Offices

Subdivisions:

(a) Earned Profits
(b) Profits in Reserve
(c) Cost of Unsold Lots
(d) Condition of Open Contracts

§ 283. Methods of Conducting an Audit

Owing to the number of schedules, trial balances, calculations of earned profits, verification of subdivision properties, etc., the working sheets of an audit accumulate very quickly if the concern is a large one, and it is important that some means of quick reference be provided. The following method of audit is therefore suggested:

The ledger balances are entered on analysis paper bound together in book form, and are numbered consecutively as in the typical trial balance. All working sheets, whether plain or ruled, should be of uniform size, say the regular journal paper, and all adding machine work should be done on such sheets, running several columns to the page, rather than on the usual narrow machine paper which may result in yards of unmanageable ribbon.

Each working sheet is numbered with the account number, and all sheets relating to that account are numbered consecutively, the account number appearing to the left of the sheet number. For example, the sheets relating to Kingslake contracts, the account number of which is 48, would be numbered in proper order, 48-1, 48-2, etc. On completion of the audit, all these sheets are arranged in numerical order, bound together, and filed for reference.

§ 284. Audit of Cash Receipts

The general cash receipts should be compared, item by item, with the carbon copies of the receipts given to the parties paying this cash, noting especially that each entry has been credited in the appropriate column and that the sources of the payments are correctly given; e.g., property numbers, mortgage numbers, and contract numbers. This comparison checks all receipts into the cash book. The "Bank" column of the cash book should be checked with the bank pass-books, and all additions should be verified.

The total cash receipts must equal the total amount deposited in the banks, as stated in § 13, and no variation, however slight, should be allowed to pass until satisfactorily explained.

The further checking of receipts to their proper accounts in the sub-ledgers will be discussed in § 286 *et seq.*

§ 285. Audit of Cash Disbursements

As all disbursements are made by check, the returned checks themselves afford satisfactory proof of the expenditure of the various amounts shown. These checks should be signed by both the cashier and the treasurer, or some other officer who does not have the handling of the actual currency. The distribution of these amounts demands constant watchfulness on the part of the auditor, who should also see that each check or voucher check, as the case may be, is approved by the proper officers and supported by sufficient vouchers.

The bank pass-books should be balanced at the close of each month, and the balances compared with those of the cash book. It is a good practice for the bookkeeper invariably to show on the cash book itself each month the reconciliations with the banks, in some such form as the following:

Memo.:

1/31/17	Bank pass-book			$7,102.45
	Cash book balance			$6,832.10
	Add checks not presented:			
		No. 2112	$110.00	
		2114	25.50	
		2116	104.25	
		2117	30.60	270.35
				$7,102.45

The enforcement of this rule insures the accuracy of the balances carried forward and saves auditors considerable time in their work.

In some cases, such as special examinations and balance sheet audits, the auditor should obtain a letter from the bank verifying the pass-book balance.

§ 286. Audit of Property Ledger

As already stated, the careful auditing of the property ledger is a most important part of the auditor's work. He is not responsible for the actual value of real estate, nor for the validity of the titles thereto, nor is he called upon to give any certificate thereon. He should, however, see that the books show the actual cost of each piece to the concern, and that all certificates required by the rules of the concern, such as appraisers' valuations, attorneys' certificates of title, etc., are in order. He should also see that the accompanying papers of value, such as title policies, abstracts of title, fire insurance policies, etc., have been duly received, or at least that definite responsibility for them rests upon some official.

It is important to see that properties covered by mortgages, especially mortgages receivable, are entered in their proper places. This not only enables those in charge to care for taxes on these properties, but enables the auditor to satisfy himself that, so far as these records show, the mortgages are not duplicated.

The entry of contracts is equally important. If omitted, such assets may be duplicated by inclusion in the Real Estate account as well as in the Contracts account. In other words, when any disposition is made of a piece of property, whether by cash sale, time sale, exchange, option, or any other method, that property should immediately be taken out of the property ledger.

§ 287. Appraisals of Real Estate

It is not unusual to engage expert appraisers to value lands, and these values are frequently shown on balance sheets in memorandum form. The auditor should compare such certificates with the property ledger, if he is to certify that these valuations apply to the property shown on the books he is auditing. It must always be borne in mind that the only rule to follow, and one to which there are few exceptions, is that which requires the books to show always the actual cost of property. (See Chapter X.)

Should values *appear* to have depreciated, it is sometimes wise to open a depreciation account similar to the Mortgage Depreciation account, in which to carry temporarily the apparent depreciation. Should actual values *be known* to be less than the book value so that there is no reasonable hope of avoiding a loss, ordinary good management would insist that the loss be allowed for on the books either by charging the loss direct to Profit and Loss account, or through a Depreciation account, a portion of which can be written off to Profit and Loss each fiscal period.

§ 288. Mortgages Receivable

The cash transactions affecting this account are checked from the cash book, while the amount of the principal is obtained from the report of sales, from the property ledger, or from the journal.

It will frequently be found that some of the mortgages are second mortgages, especially in cases where the original first mortgage was given to enable the owner to complete certain improvements, but was found insufficient in amount so that a second mortgage was given for a further advance. All such facts should be clearly noted on *both* of the subledger accounts relating to the property, the original mort-

gage being marked, "See Mortgage No..... for second mortgage," and the second mortgage marked, "Second mortgage to No....." Both mortgages should be shown on the property ledger.

A schedule of these mortgages should be prepared to accompany the balance sheet, showing the number, name of mortgagor, and unpaid balance of each, together with the total of interest and charges; and this schedule should indicate clearly all mortgages other than first mortgages. The total must agree with the Mortgage Receivable account in the general ledger, and the columns for charges must equal the sum of the following accounts:

Overdue Mortgage Receivable Interest
Mortgage Insurance
Mortgage Expenses
Mortgage Taxes

The auditor should carefully examine each account and, when necessary, show, either by footnotes or supplementary schedules, all mortgages on which either principal or interest is unduly in arrears.

§ 289. Commission Accounts

These accounts, and especially Commissions Paid, need careful examination. Commissions paid usually arise from sales of the concern's property by outside agents, and the accounts should be so kept as to show clearly to whom each item is paid and the book number of the property concerned. It is convenient to carry this information into the ledger entry in some such form as the following:

Jan. 13 Cash, J. Abbott, in full account Contract No. 475... $75

This makes it possible to ascertain quickly at any time the total amount paid to any one person, or on any par-

ticular property or section. The payment of commissions on time sales, where the commissions are paid as collections proceed, can best be recorded in a commission ledger similar to Form 12, § 21.

Commissions received arise chiefly from three sources:

1. Sale by the concern of property owned by others.
2. Commissions on loans arranged.
3. Commissions on rents collected.

An examination of the "commission business register" will quickly show if all earned commissions of Classes 1 and 2 are accounted for, while an examination of the rent records will afford a check on items in Class 3.

§ 290. Contracts

The general remarks under "Mortgages Receivable" (§ 288) apply equally to "Contracts" kept in the contracts sub-ledger, a similar schedule being prepared.

§ 291. Auditing Subdivision Property

In the case of subdivision accounts, whenever a balance sheet is drawn up, there should invariably be prepared a detailed list showing lot and block numbers, or a corresponding description, of the lots owned and unsold in each subdivision.

The number of these unsold lots, multiplied by the cost per lot, should equal the amount appearing in the Purchase account, when each subdivision is carried by itself in the general ledger, or the amount in the real estate ledger showing the cost of the property on hand.

In none of the accounts is error more likely to occur than here, and, if possible, the auditor should keep the lists of subdivision properties in his own possession with his working sheets.

§ 292. Subdivision Sales

In the case of subdivision time sales where no interest is charged, the directions of Chapters XXI and XXIII give also the manner of auditing. If the special ledger (Form 15, § 23) is used, the balances shown can easily be verified by adding machine lists. It may be well to urge the wisdom in all cases of calculating the *unearned,* i.e., the "reserve" profits; of keeping them in the balance sheet, and carrying to Profit and Loss only such surplus as the Gain account may contain in excess thereof (§171).

§ 293. Subdivision Histories

In cases where a concern deals with a number of subdivisions, the auditor will find it convenient to use the subdivision history described in § 35 (Form 31), entering thereon all the particulars as to the cost price, area, name of vendor, size of lots, method of payment, terms of contract, etc.; and, at the close of his audit, entering thereon the number of lots unsold and the book value thereof. These sheets, when bound and kept from year to year, form a convenient means of preserving information which is needed each time an audit is made. The data should be obtained from the original papers and not from any hearsay evidence, as such contracts, especially of the nature of selling contracts, involve a great many details which may not be transcribed accurately from memory.

§ 294. Equipment

Schedules of equipment should be prepared at the close of each fiscal period, in order to satisfy the auditor that the values are actually as represented. Depreciation should be charged on all items appearing in this account, and should usually average from 10 to 15% of the cost, except in the case of motor cars, where 25% is the lowest rate allowable.

§ 295. Sundry Debtors

These call for no special comment. A schedule of them should accompany the balance sheet, and attention should be called to any which are in arrears. Bad debts should, of course, be written off in this as in any other business.

§ 296. Capital Stock and Treasury Stock

The total certificates outstanding, as shown by the stock certificate book and stock register, should agree with the Capital Stock account, unless unpaid subscriptions exist. The details of checking these accounts are the same as in all other corporations and need not be enlarged upon here. The existence of treasury stock should be proved, not by certificates pasted in the book, but by new certificates which should be filed with the other securities of the concern.

In the case of a company which habitually acquires treasury stock by purchase or exchange, careful examination should be made of all entries relating to such transactions; and it should never be forgotten that gains arising from this source do not necessarily form a part of the profits from the business of the company. In such transactions the price is not always par, and confusion frequently arises in this connection. The correct rule is that, whatever price is paid, Treasury Stock account should be debited with the par value of the stock. The difference between Capital Stock and Treasury Stock will then, and only then, show the amount of capital stock outstanding and subject to dividends. The profit or loss resulting from such operations should be carried to a Reserve or Surplus account, rather than to the Profit and Loss account.

§ 297. Mortgages Payable, Contracts Payable, Bills Payable, Sundry Creditors

The sub-ledgers for these credit accounts should be

treated in a manner similar to that followed in the case of the corresponding debit accounts — "Mortgages Receivable," etc. — on the other side of the balance sheet, and schedules of each should appear in, or accompany, the balance sheet. In addition to this, the amounts due might be verified by writing to the respective holders, in the same manner as is usually adopted to verify the accounts payable of a mercantile concern.

§ 298. Purchase Accounts

As these represent amounts payable to owners of land for property the concern has arranged to sell on time, they need careful examination, for differences with the owners frequently arise when the time comes for a final settlement. It is a safe and excellent practice to verify each of these accounts by application to the owners at the close of each fiscal year.

§ 299. Unpaid Dividends

If a separate bank account be kept for payment of dividends, there should be no difficulty in ascertaining the amount of dividends remaining unpaid, by comparing the amount paid out with the total to be paid, as shown by the list of stockholders. A schedule thereof should accompany the balance sheet.

§ 300. Rents and Repairs

The amount of detailed checking which these accounts require depends largely upon the excellence of the internal check in the office. The annual entry in the property ledger of the gross rents received from each piece of property, and the total amount expended for repairs thereon, affords a rough indication as to the efficiency of this department, in addition to simplifying a statement of the net returns.

In the case of rental agencies, the fact should be proved that all collections for clients are properly accounted for and that such clients are charged with all amounts spent on their behalf.

§ 301. Reserve Accounts

These vary so greatly that no general directions can be given. They should be shown on the balance sheet in such manner as to indicate the nature or purpose of each account (§ 159).

§ 302. Reserve Profits

The audit of this item varies according to the nature of the account and the manner of keeping it. Unless a form which is similar to Form 15 (§ 23) is used, the profits in a Gain on Sales account, including profits from all time sales, whether on mortgage or contract, excluding subdivision sales, can best be kept and verified by a plan such as is described in § 304. This method applies also to those sales where interest and other charges are from time to time debited to the Income account, and the amounts paid by purchasers do not therefore represent the reduction of the indebtedness, as a portion of such payments is first applicable to interest and expenses. The profit earned in these cases depends not on the amounts paid in, but on the amount by which the debt is reduced.

§ 303. Profit and Loss Account

This account should not be disturbed between balance sheet periods. Any items which may be written off between these periods can be shown more clearly by using a Profits account as described in § 82. A statement of the Profit and Loss account for the year should, of course, accompany the balance sheet. The gains derived from rents,

sales, etc., should be grouped together, and the expenses of selling and management should be treated in the same manner. Such a statement can readily be arranged and prepared from the column analysis, as suggested in Chapter XXVII.

§ 304. Auditing Time Sales

In order to facilitate the work of the auditor in obtaining the amount of the gain on sales which may be carried to Profit and Loss each year, the following plan has been worked out and has been used in practice for the last six or seven years. Analysis paper is taken, and the various columns used are about as follows:

1. Mortgage Number, or Contract Number.
2. Name of Purchaser.
3. Original Amount of Gain.
4. A fraction made up as follows: The denominator is the total amount of the original sale; the numerator is the amount by which the balance has been reduced since the last examination.
5. Amount of Gain Realized, i.e., the amount of the dollars and cents, obtained by multiplying the original gain by the fraction in the preceding column.
6. The Amount of Gain Unrealized at Close of Year—obtained by subtracting column 5 from column 3.

The Gain on Sales account in the general ledger is taken and the details of each item found therein are entered in columns 1 and 2. Column 3 is then added, and the total should, of course, agree with the total credits of the Gain account in the ledger.

The contract and mortgage ledgers are then taken and each sale is examined and the fraction appearing in column

4 is determined. It must be noted in this connection that the numerator of the fraction does not necessarily agree with the total amount of payments, for if items for taxes, insurance, interest, or any other expense have been charged to an account, the debt is, of course, reduced by the amount of payments less such charges. As has been said in § 175, it is this reduction, and not the amount of the total payments, which gives us the proportion which we are entitled to carry to Profit and Loss.

The most convenient practice is to make up as many such sheets as are necessary, to add each sheet independently, proving columns 3, 5, and 6 against each other, and adding a summary sheet on which the totals of all these sheets appear and which gives the totals to be carried to Profit and Loss. If the sheets of one year are kept, they form a basis of the statement for the following year; and in the second and succeeding years columns 1, 2, and 3 are used without rewriting. Reference to them in following years is simplified if, as each item is paid, it is ruled out across the entire page in colored ink.

If additional columns 7 and 8 are employed, the fraction representing the amount earned for the second year may be inserted in column 7, and in column 8 the same item in dollars and cents.

Although the description of this method may seem long, in practice it will be found that the fractions can be very quickly determined and the entire sheet completed with comparatively little labor.

One special use of these sheets is to provide the bookkeeper or auditor with the amount of profit left as unearned by any one contract should such contract be cancelled; and it saves considerable confusion, when drawing the journal entry covering such cancellations, if reference is made to these sheets and the exact amount of unearned profit ascer-

tained. It has been found that bookkeepers are usually disposed to write off the amount originally credited, which, of course, necessitates correcting entries and tends to obscure an account.

§ 305. Trustees' Accounts

The forms of these are so varied and so constantly increasing that it is useless to attempt to give even a list of them. It may be said in general that the details are usually described in a document in the nature of a deed of trust, a mortgage agreement, or the "holding" document of some form of collateral security. Whatever the form may be, the auditor should insist upon seeing the original document or a reliable copy thereof, from which he can make an analysis of all the particulars.

Upon such an analysis being made, the auditor should see (1) that the accounts are so arranged as to show clearly the transactions, especially any particular points involved, and (2) that the terms of the agreement have been complied with. This may involve an examination into the disposition of proceeds of sale of lands involved, the proper entry of interest, the proper lodging of securities, etc.

CHAPTER XXX

AGENTS AND BROKERS, AND THEIR ACCOUNTS

§ 306. Accounts for Office Buildings and Apartment Houses

Proper accounting for modern office and apartment buildings necessitates the maintenance of accounts which show the receipts from each office, store, apartment, flat, etc., and the total receipts from each building. As to repairs, it is generally proper, in the case of apartment houses, to apportion these to each unit; while in an office building this may be unnecessary, although it is important that the record show such details as repapering or repainting each room. There are also fixed charges, such as taxes, insurance, interest, and the operating charges for janitors, heat, light, water, power, etc.

These accounts are usually best kept in a tabular ledger similar to Form 16 (§ 23), which, by the use of "short leaves," can be so arranged that each folio will contain the business for a year. The total cash receipts shown for each month will agree with the total of a corresponding column in the cash book. The debit accounts can be kept in the usual simple form, separate accounts being opened for each building, as:

Building A:
- Taxes
- Repairs
- Insurance
- Janitors
- Elevators

The general rules for the collection of rents apply here, and all orders for material and repairs should be made out on regular forms, a carbon copy of each being retained in the office. With such a system, it is easy to prepare an annual summary, using Form 47 for this purpose.

BUILDING A

REPORT FOR THE YEAR 191..

	January	February	March	Etc.
REPAIRS				
Painting Inside	....	....	....	....
" Outside	....	....	....	....
" Roof	....	....	....	....
Plumbing	....	....	....	....
Carpenter	....	....	....	....
Elevators	....	....	....	....
Heating System............	....	....	....	....
Lighting "	....	....	....	....
Fixtures	....	....	....	....
Total................	....	....	....	....
OPERATING EXPENSE				
Janitor	....	....	....	....
Elevators	....	....	....	....
Light	....	....	....	....
Heat	....	....	....	....
Water	....	....	....	....
Etc., etc.................	....	....	....	....
Total................	....	....	....	....
FIXED CHARGES				
Taxes	....	....	....	....
Insurance	....	....	....	....
Etc., etc.................	....	....	....	....
Total................	....	....	....	....
GRAND TOTAL.......	....	....	....	....

Form 47. Annual Report of Office Building

§ 307. Monthly Reports

The form of monthly report rendered by an agent to his principal varies greatly. As a rule, where an owner places several pieces of property in the hands of an agent, Form 48 may be used. This statement should be accompanied by a receipt for each disbursement reported.

John Doe AGENT,
DR. to Richard Roe OWNER
For the Month of September 1917

	DR.	CR.	DR.	CR.
18 High Street				
Rents collected		$105.00		
Plumber, as per attached	$24.00			
Carpenter, " "	18.50			
	$42.50			$62.50
42 Main Street, Rents		85.00		85.00
Total net credit balance				147.50
Less Commissions				9.50
Check herewith (or credit on acct.)				$138.00

Form 48. Monthly Report of Rental Agent

§ 308. Brokers' Records

The scope of the present work precludes any complete treatment of real estate brokerage and the forms used therein. Under the head of "Commissions" (§ 309), a few simple and effective rules are given as to the formal accounts for sales and loans. It is only possible here to touch on some points of general importance in the brokerage business, which varies so greatly in scope and in character of

property handled that the details of each case must be worked out as a separate proposition.

The broker should keep accurate records of the properties he has for sale, and these should be so arranged that any desired reference can be quickly made. For this purpose, bound books, cards, and loose leaves have all been pressed into service. Bound books are not elastic enough for such temporary records, and cards present several disadvantages. A loose-leaf record is therefore the most suitable. A small loose-leaf volume may easily be carried while the broker is taking a customer to inspect various properties, and the integrity of the record is not destroyed, as it is in the case of a card system, from which cards are withdrawn. Several copies of a leaf can be filled out at one writing, and each may be on paper of a different color. This feature is of great convenience, for a broker should

NO.	STREET	TOWN OR CITY	SALE PRICE
216	Andrews Street	Rochester, N.Y.	$4500.00

STORE OR HOUSE	BUILT OF	FINISHED IN	NO. OF ROOMS	W.C.	BATH	CELLAR	TO RENT / DATE / TIME
House	Brick	Natural Wood	8	Yes	Yes	Cement	Yes / Mar. 1st / 3 yrs.

MORTG.	RATE	WHEN BUILT	TIME	SQ. FT. OF LAND	LOT FRONT 45'	LOT DEPTH 100'	SEWER	HOW LEASED
$3000	5%	1898	Spring	45,000	BUILDING - 25'	BLDG. - 40'	Yes	

HELD BY	NOW LEASED	WATER	GAS	ELEC. LIGHT	FIRE PLACE	MANTELS	SET TUBS
1st Nat'l Bank	By the year	Hot & cold	Yes	Wired	No.	One	2

LAUNDRY	FRUIT TREES	PORCH	SCREENS	STORM HOUSE	RANGE	NO. OF STORIES	SIDE OF ST.
In Cellar	None	One	Yes	Front door	No	2½	Right

LOWEST PRICE	TERMS	BLDG. TAXED	LAND TAXED	WILL TRADE	STABLE	OTHER BLDGS
$4,250 cash	$300 down	$4000.00	$500.00	No.	No	None

DISTANCE FROM CARS	FURNACE	HOT WATER	STEAM HEAT	ELEVATOR	NO. OF ENTRANCES
3 minutes	Yes	Both floors	No	No	Two

OWNED BY	ADDRESS	DATE
Henry J. Wilson	47 Adams Street	Feb. 6, 1917

KEY AT	BUSINESS RECEIVED FROM	OTHER AGENTS	COMMISSION
214 Andrews St.	Owner	None	2½%

REMARKS: House has been occupied by small family for last six years - is in good repair and in good neighborhood.

Form 49. Broker's Record

have his properties listed by (1) owners, (2) localities, (3) classification, i.e., dwellings, offices, etc.

Form 49 is convenient for such listing and is kept in stock by different manufacturers. Form 50 is somewhat similar and is suitable when cards are used. It is so simple that, if desired, a rubber stamp may be used to imprint the cards. Here, again, cards and inks of various colors may be employed.

Another method of keeping track of properties is the map and tack system. This consists of a large wall map of the city or neighborhood in which the broker operates, mounted preferably on a backing of soft wood, together with a number of pins or small flags of various colors, one color being used to indicate property for rent; another, dwellings for sale; etc. When a piece of property is listed, a pin is stuck into the map at the proper place, and, if a flag is attached, there is written on this the name of the owner and the price, e.g.: "Allen, $4,500."

WANTS, BUY, RENT OR SELL

Price $..............
Terms ....
Rent ....

Location .... By .... 19..
Building .... Story..............
Rooms, 1st Floor .... 2nd .... 3rd ....
Size Lot .... Alley ....
Sewer .... Light in Street .... Light in House ....
Bath...... Closet...... Laundry...... Basement...... Cellar.......
Water .... Heat .... Barn ....
Remarks...
Name ....
Date .... Address ....

Form 50. Broker's Card Record

The advantages of such a plan as a means of ready reference are as obvious as the flags themselves. A disadvantage of this system is that the flags and pins could easily be displaced by some irresponsible party in the office, thus vitiating the entire system. It need not be said that a map and tack arrangement does not enable the broker to dispense entirely with a written record of the properties in which he is interested.

§ 309. Commissions

Bookkeeping for commissions consists in its simplest form in merely recording, through the cash book, the commissions as collected. It is the custom, however, for brokers engaged in this class of business to attend to other matters, such as procuring abstracts of title, payment of taxes, etc., which involve the payment of money for purchasers. In such cases, a detailed account of all transactions should appear on the books. Many items, such as arrears of taxes, are easily overlooked, and the proper protection of client and broker calls for a full record.

Let us assume that the concern arranges a loan of $5,000 from John Doe to Richard Roe, paying $42 for an abstract, $50 for attorney's fees, $2.50 for recording fees, $80 for taxes, $10 for appraiser's fee, and that it charges $5 for drawing the papers and $100 as commission or brokerage.

The expenditures and charges made by the concern will be entered on the cash book to "Doe-Roe Loan," and if the amount of business warrants it, special columns will be reserved on each side of the cash book for loans and sales. John Doe pays the $5,000 to the concern. A small subledger (Form 13, § 22) is opened for these brokerage transactions, the record of both kinds being kept in one book under separate indexes if desired.

On the general ledger all the above-mentioned items will

be charged and credited to Loans account, either by individual items or, in the case of a columnar cash book, by monthly totals. The sub-ledger account will read as follows:

Doe-Roe Loan

Abstract	CB	$42.00	John Doe...............	$5,000.00
Attorney	CB	50.00		
Recording	CB	2.50		
Taxes	CB	80.00		
Appraisers	CB	10.00		
Drawing Papers...	J	5.00		
Brokerage	J	100.00		
Paid R. Roe.......	CB	4,710.50		
		$5,000.00		$5,000.00

The charges for drawing papers and for brokerage are posted to the general ledger from the following journal entry:

Loans..	$105	
To Loan Brokerage..........................		$105
Fees in Doe-Roe loan; commission, $100; drawing papers, $5.		

Such an account shows at once the payment of all deductions for which the concern is accountable, and the state of any transaction may be seen at any time. It also shows clearly the profit from this particular class of business. If Richard Roe has sold the property to John Doe, the same entries might equally well appear, except that the brokerage journal entry would read as follows:

Sales	$......	
To Sale Brokerage.....................		$......
Brokerage in Roe-Doe sale.		

CHAPTER XXXI

REAL ESTATE ORGANIZATIONS

§ 310. Abstract Companies

In some states there are so-called "abstract companies," whose business it is to keep abstracts of public records and to prepare an abstract of title to any piece of property desired. In other states, titles are insured by title guaranty companies under "title policies." It is not proposed to discuss here the form of these abstracts or policies, or the method of preparing them, but merely to consider the papers after they reach the real estate concern.

The only safe rule is never to buy real estate without some such abstract. It is the accountant's duty to see that such a document accompanies the other papers when any property is acquired. As these abstracts and policies represent money, and sometimes large sums, they should be dealt with as carefully as cash. They are perhaps harder to keep track of, more particularly because they are so frequently borrowed by prospective purchasers or their agents or attorneys.

An easy method of caring for abstracts is to number each, as soon as received, with the real estate number of the property covered, and then to keep them in numerical order in a division of the safe or vault reserved for such purpose. In this way any abstract can be found almost instantly.

As practically every purchaser, after receiving his deed, borrows this abstract for examination, a record of abstracts loaned from the office is a necessity. The following form, which is kept in a small loose-leaf binder, has led to the sav-

ing of large sums of money in the course of some years' use. As many lines as necessary should be provided under each heading.

DEED
ABSTRACT NO...............................
....
........papers..............................
Sent to.....................................
For...
Date..
I hereby acknowledge receipt of the above-mentioned papers and undertake to return same to the.................; or, when called upon to do so by said Company, to provide at once new copy of same prepared by the..........Abstract Title and Security Company, at my own expense.

....

Form 51. Record of Abstracts Loaned

On the final disposition of a piece of property and the delivery of deeds, etc., the abstract is usually delivered to the purchaser, or the policy is indorsed in favor of the purchaser. In such case there should be inserted in the abstract file a slip of paper the same size as the folded abstract, bearing the number of the abstract or policy so delivered and showing the disposition thereof.

§ 311. Leasehold Companies

There is a class of concerns differing from agencies, sometimes known as leasehold companies, which rent from owners office buildings and similar properties, and operate them at their own risk and for their own profit. The accounts of these companies will, of course, be on lines almost identical with those of an agent.

§ 312. Building and Loan Societies

While the number of these societies is perhaps decreasing, many are still in active business. The details connected with their work, however, lie outside the limits of the real estate office and of the present volume. In a general way it may be said, that these companies depend upon the interest and fees which they charge their borrowers, the former being calculated by one of the methods described in Chapter XIX.

The question of ascertaining the profits of such societies is not a difficult one when proper tables are prepared to facilitate the apportionment of receipts and outstanding mortgages between the income and investment accounts. The use of a columnar ledger or columnar journal frequently results in a great saving of time, and yields clearer results than do the more usual forms.

§ 313. Cemeteries

As the business of a cemetery company or association is based upon dealings with land, it seems appropriate that the accounts of such concerns should be mentioned here. In the case of a cemetery company organized for profit, few difficulties are encountered. A tract of land is bought, subdivided, and sold, each sale yielding its profit, while the expenses of maintenance and operation are chargeable against the income. No difficulty should be experienced in arriving at the results of the business for any given period.

There are, however, springing into existence throughout the country cemetery associations which are not organized for profit, but for the purpose of providing in perpetuity a burial place. Such an association also provides for the perpetual care and beautifying of the cemetery as a whole, as well as for the proper maintenance of the in-

dividual plots that may be placed in its care by the owners. Any surplus is devoted to further improvements or placed in a reserve, but in no case assumes the form of dividend or profits.

In order to carry out such provisions, it is necessary to establish separate trust funds, the income from each of which is devoted to a specific purpose, such as general maintenance, general improvement, perpetual care of lots, etc.

To devise a system of accounts to cover these various matters, and to provide as far as possible for the future so that an auditor, fifty or a hundred years hence, may easily trace the history of each trust fund established, is a matter of unusual complexity and should be placed in the hands of a competent accountant.

§ 314. Cemetery Subdivision Accounts

Cemetery accounts dealing with land present a problem very similar to that discussed in Chapters XXII and XXIII, under "Subdivision Properties." As a rule, a tract of acreage land is bought and occasionally the whole of this is at once platted, improved, and developed, but, more generally, it is divided into sections which are developed one at a time.

The cost of acquiring the entire tract should first be obtained, and should include the purchase price and legal expenses, together with such costs as fencing the entire tract, surveying and platting it, and possibly also providing for main roads, superintendent's dwelling, offices, and greenhouses. This total cost might also include the cost of any chapels or mortuaries erected; although, if special charges are made for the use of these, it may be better to keep them by themselves. Frequently, the cost should include an estimate of the expenses for general improvements contemplated during the next few years.

The cost of the whole being arrived at and charged to Land account, it is, when necessary, apportioned either at so many dollars per acre of the whole tract, or, if the entire tract is divided into sections which are to be developed one at a time, the total cost is apportioned to these various sections. The result of this is that the balance of the Land account always shows the cost of the unplatted portion; the cost of each section as it is platted being transferred to "Platted Land," or to "Section No. 1," "Section No. 2," etc.

When one or more sections have been platted, the cost of each section is divided among all the lots contained therein, either by finding the average cost or by an appraisement. Each lot is then treated as in subdivision properties. The time of payment is, however, usually shorter than in the case of time sales, and there is a far greater probability that all lots sold will be paid for — a certainty arising from the purpose to which the lots are put. This being the case, it is quite frequently permissible for such an association to regard the gain on each lot sold as "realized," although the actual realization may be slightly postponed.

In the case of cemetery associations not organized for profit, it is frequently obligatory upon the management to transfer a portion of the purchase price, or of the profit, to some particular fund. For this reason, it saves many complications if the gain be always regarded as "realized," and in practice the lapses will usually be so few that no difficulties will be experienced in charging back the profits in these cases.

Especial care must be taken in differentiating "Capital Expenditures" from those chargeable to Revenue account, because it is usual for the same set of men to perform services apparently of a similar nature but chargeable to en-

tirely different funds. For instance, one gang on the same day may:

1. Open or close a grave for a funeral.
2. Work on an individual lot taken care of for the owner on a yearly basis.
3. Work on a similar lot which is under perpetual care, owing to a trust fund having been formed for the purpose.
4. Work on general flower beds or shrubbery.
5. Work on grading a new section about to be opened.
6. Work in greenhouses on growing plants.

Nos. 1 and 2 are chargeable to two different operating accounts; Nos. 3 and 4, probably to two different trust fund income accounts; No. 5, to the capital account for improvements (a cost account); No. 6, to another operating account. It is not necessary to go further into details, however, as enough has been said to indicate the general methods applicable to cemetery real estate accounts.

CHAPTER XXXII

DEPRECIATION

§ 315. Depreciation of Realty

In real estate affairs, depreciation, properly so called, applies to buildings or improvements only, and not to the land itself. It is true that land values frequently decrease, but such decrease is seldom brought about by natural causes. Perhaps it is the result of a fictitious initial value, as in the case of a punctured "boom"; perhaps of a change of fashion, which prevents the old-time rents from being realized. These human causes, however, do not imply change in the land itself, but merely show that the original estimate of the value was excessive or that the demand has diminished.

As the process of depreciation in the case of buildings is constant and unavoidable, it must be dealt with in some way. If no notice is taken of it, and the property is not sold, the owner may be unconscious of it until a sale is attempted or a fire occurs. Then he discovers that the prospective purchaser or the insurance adjuster, as the case may be, will deduct for depreciation some material amount from what the owner considers the present, but which is really the original, value of the property.

§ 316. Nature of Depreciation

Depreciation is closely allied to the repairs, renewals, improvements, and wear and tear, which have already been considered. While repairs represent the re-establishment of a diminished value arising from use, depreciation rep-

resents a shrinkage in the value beyond that which can be re-established by mere repairs.

Another characteristic feature of depreciation, and one which prevents it from being a proper offset to any appreciation of values, is the fact that it represents what has gone and is already lost, whereas appreciation is a thing hoped for — believed in, but not yet realized. "A charge for depreciation has no relation to profits, and must be made whether profit is being made or not; or, to express it in other words, the true theory of depreciation requires the replacement of the continuous waste of capital assets by the capitalization of an equivalent amount of revenue."*

§ 317. Systematic Treatment of Depreciation

The Interstate Commerce Commission has been one of the most effective factors in the introduction of more scientific accounting methods in this country. This is not because of its legal status or of its legal powers, but because its rules are based on the collected experience of a large number of trained men working on similar problems under different and independent conditions. Perhaps no other accounts have had the advantage of such experienced consideration as those under the jurisdiction of the Commission and probably no other set of accounting rules has such force as those which it has laid down. The fixed practice of charging depreciation runs through the accounts of all its departments, and this practice based as it is on a fundamental principle, cannot fail to have a marked effect upon the accounting practice of the American business world.

§ 318. Percentage of Depreciation

It is impossible to adopt any fixed percentage of depreciation on a given class of buildings; for occupancy, con-

*R. N. Carter, in *The Accountant,* March 7, 1908.

struction, and locality play so large a part in determining the amount. For example, a frame building in a dry, northern climate will outlive, several times over, a building similar in all other respects but situated in the warm, damp climate of some of the Gulf States. The difference in the life of materials in different climates is demonstrated still further by comparing yellow pine railway ties when laid in New England and in Florida. Again, two similar and adjacent buildings will depreciate very unequally if one is occupied by a careful owner and the other by a careless tenant.

§ 319. Calculation of Depreciation

There are several distinct methods of calculating depreciation on the buildings;

1. By dividing the cost of the building by the number of years it is expected to last, and writing off each year an amount equal to the quotient, or by writing off some fixed annual sum arrived at after considering the facts of the particular case.
2. By writing off each year a fixed percentage on the diminishing values.
3. By writing off each year a fixed percentage on the original cost.
4. By adding to the cost its annual interest at an agreed rate, and at the same time writing off each year an amount which will reduce the value of the building to zero or to scrap value at the end of a given term; this is usually known as the "annuity plan."
5. By periodic appraisals of the buildings.
6. By following some of the recognized tables of depreciation; a method similar to 2.

The second method is probably the one most generally adopted, and mainly for two reasons:

First, it tends to equalize the charges of maintenance, as the heaviest deductions are made at the beginning when repairs are light, and diminish as the expense of repairs grows heavier.

Second, the requisite data for its calculations can always be quickly and easily obtained.

Whatever method is selected, the chief difficulty lies in determining the proper percentage to apply. Those in general use vary from 1½% for such buildings as stone churches, to 10% for frame tenements. An average figure would probably be about 5% for good frame buildings, and 2½% or 3% for brick, stone, or concrete structures. As a matter of fact, this question can only be settled by that which is the basis of good law and of good accountancy — common sense. It must not be forgotten that, while an insufficient amount may cause an unexpected loss, an excessive amount tends to create something in the nature of a secret reserve.

§ 320. Depreciation vs. Appreciation

It is probably true in the case of many land companies, particularly those whose business is not chiefly in the older and larger cities, that there is ever present the knowledge that, while buildings may be depreciating, the land is appreciating. This is true as to the holdings of the majority of well-managed concerns, and the accountant has to show good cause if he insists on writing down the value of buildings why he cannot agree to the writing up of the land.

The average business man usually agrees that losses should be written off as soon as discovered and that no profits should be entered until earned; yet, when the accountant is not willing to regard appreciation of land as a

proper offset to the depreciation of the improvement, the owner often has the impression that he is being imposed upon. He fails to realize that correct accountancy does not deprive him of any profits, but merely guards him against self-deception and against possible losses in case values should depreciate, the final result, in any event, depending upon the price actually obtained for the property in question. In this connection it must be noted, however, that the principles set forth above are not held by all authorities. Some accountants believe that if a certain price has been paid for a piece of improved real estate, no depreciation should be shown unless the value decreases.

§ 321. Depreciation on the Balance Sheet

When depreciation on buildings is taken on the books, there are at least two methods of treatment, e.g.:

1. To reduce the amount of the Real Estate account by the amount of the depreciation.
2. To open a depreciation account (not a "depreciation fund"), which is credited with the amount of depreciation decided upon, the debit entry being made to Profit and Loss account when the property is finally sold.

The second is by far the better plan, for it conforms to the practice of having the Real Estate account show the actual cost, and it shows plainly the amount to be written off; it is clean bookkeeping. In drawing up a balance sheet, the amount of this depreciation should then show, not as a liability, but as a deduction from Real Estate:

Real Estate Cost......................	$185,000
Less Allowance for Depreciation on Buildings	7,500
Net Real Estate.............	$177,500

§ 322. Depreciation on Leasehold Property

While the remarks already made apply to buildings on freehold lands, it is evident that they apply with even greater force to leasehold properties. Whether the leases are long or short, the sum of the charges, (1) premium, if any, paid for the lease, and (2) cost of buildings erected which revert to the owner of the fee at the expiration of the lease, may be treated as an asset at the beginning of the lease, and should be reduced by equal periodic amounts so that they disappear when the lease ends. In this case, unlike that of freehold property, the value of the lease appearing on the books is reduced on the face of the ledger.

The question of depreciation has been discussed fully and clearly by eminent writers both in England and in this country, and the reader is referred to these authors should he desire to pursue the subject further.*

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*"Auditing," by Lawrence R. Dicksee; "Auditors, Their Duties and Responsibilities," by Francis W. Pixley; "Accounts, Their Construction and Interpretation," by William Morse Cole; "Modern Accounting," by H. R. Hatfield; "Auditing, Theory and Practice," by Robert H. Montgomery; "Principles of Depreciation," by Earl A. Saliers.

CHAPTER XXXIII

INSURANCE RECORDS

§ 323. Expiration Register and Card System

The accountant should be careful to keep a record of the date on which each policy expires, and he should also see that every building in which the concern has any interest is properly insured. The insurance records may be kept in an "expiration register" specially prepared for the purpose, or by means of a card system. A register such as is used by many fire insurance agents can be bought already ruled, the headings being self-explanatory.

The writer prefers a card system for this purpose, with ruling as shown in Form 52, which has proved itself capable of meeting all requirements. Under this system a card is numbered for each building to be insured, the numbers corresponding with the numbers of the properties shown on the property index and property ledger. As the insurance is written, the cards are filled in and filed. When all the cards are filled out, therefore, we know that every building is insured.

An even better method is to have a duplicate record, i.e., an original and a carbon copy. One set is then filed in order of dates, and one set in alphabetical order of owners.

Another set of cards is also made up and filed at the same time for use as a tickler, this second set containing a card for each month of the next one, three, or five years, according to the terms for which policies are written. Each card of this second set is headed with the name of its month,

and as each card of the first set is written out, its number is entered on that card of the second series which represents the month in which the particular policy expires. The result of this is that if any card of the second series is taken out, we have before us a list of all policies to be renewed in the particular month represented by that card.

At the end of each month in which expirations occur, all the new policies written during that month are checked against the expiration card, in order to see that all renewals have been properly made; the particulars of the new policies are entered on the proper cards in the first series, and the property numbers of the new policies are also entered on the cards of the second series for the months in which they expire.

The policies themselves should be arranged according to the months in which they expire. This takes but little time and gives a check upon the expiration card. As each policy is received, it should be examined to see that it is correct as to date, amount, name of assured, and that it af-

No. .... Property ....

House ....

Assured .... Loss to ....

Company	No.	Dated	Expires	Amount	Premium	
....	....	....	....	....	......	....
....	....	....	....	....	......	....
....	....	....	....	....	......	....
....	....	....	....	....	......	....
....	....	....	....	....	......	....

Form 52. Insurance Card Record

fords proper protection for the mortgagee, if any. It will be seen that the simple system here outlined contains merely the records required by the assured. It is not intended as a record for the insurance agent, which is necessarily somewhat more complicated.

§ 324. Life Insurance in Connection with Time Sales

It is only within the past few years that life insurance has become so closely connected with real estate as to warrant its mention in a work such as this. They sometimes, however, come into contact at two points: first, in connection with time sales, and second, in connection with loans.

The simplest example of insurance in connection with time sales is afforded by the transactions of those development companies which offer to sell lots under an agreement that the purchaser is required to pay "no interest, no taxes," and that, should the purchaser die during the life of the contract, the property will be conveyed to his estate free of all encumbrances.

Possibly some of these companies may effect insurance on the lives of its purchasers on a plan similar to what is known as "industrial insurance," or some special form of policy under which the liability and the premiums diminish year by year as the liability insured against decreases, this form probably being the most economical policy obtainable. In such cases, all premiums paid by the concern should be charged to the expense of the particular subdivision, and be charged against Profit and Loss at the closing of the books.

It is, however, a more general custom for the concern to carry this insurance itself; that is, to run the risks, and, if a purchaser die, to give a deed of conveyance to his estate. In these cases the best practice is to close the account of

such a contract by a journal entry in the following general form:

Life Insurance............................	$......	
To Contracts.........................		$......
To close Contract No. 121, John Doe, deceased, conveyance of lot ...., blk. ...., being made to his estate.		

This entails the opening of a Life Insurance account in the general ledger, to which all such accounts are charged, showing in each case the subdivision concerned; and, on the closing of the books, the balance of the account is closed into Profit and Loss. This is clearer than carrying it as an item in any general expense account, and far preferable.

§ 325. Life Insurance in Connection with Mortgages Payable

Certain life insurance companies have in recent years inaugurated the practice of lending their surplus funds on mortgages at a low rate of interest and free of brokerage, on condition that the mortgagor take out with the lender a life insurance policy, to such an amount that the annual premiums will amount to, say, 5% of the amount of the loan, and will undertake to maintain this during the life of the loan. The policy may be taken out either on himself or on others designated by him, and, in the event of the death of one of the insured during the period of the loan, the insurance is credited to the loan.

Such agreements must be carefully examined to determine the proper disposition of moneys paid for premiums. The interest payments are, of course, treated like all other interest on mortgages payable. The premiums may be charged to a Life Insurance account and carried as an asset during the life of the loan. In event of the

death of one of the assured, the amount of insurance collectable, less the premiums paid, may be debited to Mortgages Payable account and credited to a special surplus account.

In the event that none of the assured dies and the mortgage is satisfied when due, the amounts paid as premiums may remain as an asset if the policies are continued for the benefit of the business, or if they have an exchange or surrender value equal in amount to these premiums. If, however, the policies have no such value, the premiums must be written off to Profit and Loss. On this account, proper arrangements should be made at the time the loan is entered on the books, to avoid the possibility of having to write off a considerable sum at the end of a few years.

CHAPTER XXXIV

RENT RECORDS; BUILDING ACCOUNTS

Rent Records

§ 326. Rentals

The work of the rent department is of such importance in so many offices that a special consideration of its accounts, in addition to the general discussion of rents in Chapter XIV, is desirable.

Unless the number of buildings from which rent is to be collected is very small, it is advisable to treat the business of the rent department as distinct from that of the general office, the rent records being contained in a separate set of books consisting of a cash book, journal, and ledger, and the current funds of the department being deposited in, and disbursed from, a special and distinct bank account.

The basic principle of rent accounts, large or small, is that the accounts deal not with the tenant, but with the building. It is obvious that if the account of any one building is kept in the tenant's name, there may be frequent changes in the title of what is practically one account. This is especially true in connection with small tenement property where tenants frequently move out, and even in, without notice and between the weekly calls of the collector.

When a real estate office has only a few buildings to look after, it may not be necessary to do more than to credit collections to rents and expenditures to repairs, using perhaps a column in the cash book for each class. This does not show separately the earnings of each house, but this

separate record may, when necessary, be kept in memorandum form on loose-leaf ledger sheets.

In those offices where there are sufficient houses to form what may be called an agency, a complete set of books should be installed. The advantage of this is two-fold: it keeps separate rent money, part or all of which may belong to clients, and it relieves the general books of a large quantity of detail without adding to the labor required.

§ 327. Records Used

The first record is the rent register (Form 32) described in § 37, and kept as therein indicated. Each house taken in charge should at once be entered on this record, and an account therefor immediately opened in the ledger.

The rent receipt book (Form 33) is described in § 38. The use of some such form should be insisted on.

The cash book is of the simplest form, and generally only two columns on each side are required. On the debit side, the first column is for the entry of each separate item; the other, for the entry of the total collections for the day, which should also be the amount of the bank deposit on the following day. The other side of the cash book is as simple.

Where rents are collected for a comparatively small number of owners, or where it is desirable to keep apart the collections and disbursements for one or more accounts, a columnar cash book may be used, a column on each side being devoted to one client. In this case the total bank deposit should also be the total of all the debit columns for the day, i.e., the day's collections. This method is convenient where the owners do not number more than, say, twenty, but a columnar book containing many more columns than this becomes inconvenient to use.

Most of the items on the credit side will be weekly payrolls or monthly bills, and each such item should be properly

distributed before being entered on the cash book, the full distribution being shown there, as this forms the basis of charges against each building. Sometimes the rent accounts contain a General Expense account, to which are charged such items as salaries of collectors, maintenance of horses, buggies, etc. Such an account, however, usually belongs in the general ledger, where it shows the expenses incurred in order to collect the rents or to earn the rent commissions shown in credit accounts on the general ledger.

§ 328. Repairs

In some offices where many buildings are cared for, the amount of repair and building work demands a constant force of workmen, usually under a foreman. This frequently renders advisable the purchase of building materials in quantity, which are stored in a yard. Under these conditions, the rent ledger should contain a Yard account, to which is charged all materials not bought for any particular building. Each week the foreman should render a statement of all supplies issued from the yard — and this is credited through a journal entry to Yard account and debited to the buildings concerned at cost price, including hauling, in a manner similar to that used in connection with any properly conducted storeroom.

At the end of each fiscal period, an accurate inventory should be taken of all material in the yard, and if this does not agree with the balance in the Yard account, the difference is credited or debited to Rent account, and the Yard account for the new year is opened for the amount of the actual inventory. The rent ledger must also include a General Office account, which is charged with all moneys transferred from the Rent account.

Where it is the custom to have repairs made by outside firms of plumbers, builders, etc., all orders for such work

should be given on printed forms, a carbon copy of each being retained in the office. These should be numbered consecutively, and bound in the same manner as the receipt books. A separate order should usually be made for repairs on each house, and the contractor should be instructed to render a bill in duplicate for work done on each house, especially where rents are collected for other owners, so that such bill may be attached to the monthly statement of rents collected.

§ 329. The Rent Ledger

From the rent cash book each item is posted to the rent ledger. Several forms of rent ledger are shown in Forms 36 to 38 (§§ 42, 43). There are also many other special forms of this ledger which can be obtained from any good stationer.

Where rents are collected for clients, the ledger account of each house should show clearly the name of its owner. All rent accounts can then be treated in precisely the same manner, whether they belong to the concern or to a client. At the close of the month, a regular trial balance showing the monthly debits and credits to each house, is taken from the rent ledger, which book, if kept as above outlined, is self-balancing. The trial balance would be similar to the following:

18 State Street..............................		$50.00
22 " "	$20.00	50.00
502 Main Street (Joe Doe)................	15.00	40.00
45 King Street..............................	14.00	80.00
80 Hospital Street (Richard Roe)..........		150.00
Etc., etc..		....
General Account..........................	845.00	
	$2,453.00	$2,453.00

From this trial balance a summary may readily be prepared, classifying the debits and credits applying to each client and forming the basis of the monthly statement to be rendered to each. Supposing that all collections are credited on the general ledger as transferred to Rent Department, the journal entry would be of the following form:

Rent Department	$1,133	
To Joe Doe		$485
" Richard Roe		545
" Rent Commissions		103

The account with each client should be carried on the general ledger, for it is a common thing for them to draw, sometimes in advance, a fixed or varying monthly sum; or it may be necessary to charge their accounts with sums paid for insurance, taxes, etc., which pass only through the general cash book.

§ 330. Arrangement of Rent Ledger

The arrangement of the rent ledger depends upon the conditions and upon the taste of the individual who arranges it. If a bound ledger is used, all houses should be entered in a simple register giving book number, address and name of owner.

This forms an index for each house; and in case of tenement or similar property, it affords a serial number which may be stencilled or painted in some inconspicuous place on each house, in order to enable a collector to identify it at once. This is especially useful in the case of suburban property where street numbers are sometimes indefinite.

If a loose-leaf form of ledger is used, the accounts may be indexed (1) by streets; and (2) by owners.

If collectors bring in the rents, the arrangement by streets is far more convenient, as it brings together in the

ledger, houses in the same neighborhood which are likely to appear together in the collectors' reports.

§ 331. Rent Collectors

In many instances it is necessary to employ collectors. As the salaries paid to collectors are usually not large enough to attract men of high clerical training, and as the work entails the entering of a large mass of items, it is better for the concern and fairer to the collectors to provide a system of reporting which shall be positive and not involve unnecessary labor.

The use of the carbon receipt book is the first essential (Form 33, § 38). The collector, at the close of each day's business, should himself prepare a statement of his total collections (Form 35, § 39).

It is incumbent on anyone handling the cash of another, to render a statement, and a rent collector is no exception to this rule. Attention is called to this point because in many offices the preparation of this report is left to some other clerk. This tends not only to misplace the responsibility, but also leads to errors, for rent receipts are often hurriedly written and difficult to read. As the reports should show the name of each tenant, they should be typewritten, and it is a good practice to let the collector dictate all such reports from his duplicate rent receipts to a typist.

When the report is made, the collections are added and the report is turned over to the cashier, together with the receipt book upon which it is based and the amount of cash called for in the total. The cashier checks each receipt against the statement, and, as he does so, he should mark with a pen or rubber stamp the receipt itself to show that it is accounted for. On proving the additions and checking the total against the cash received, the cashier returns all

unfilled receipt books to the collector, and files the completed receipt books in numerical order.

Particularly in the case of tenements where the rent is paid weekly, it is necessary for the collector to know what rent is payable. To furnish this information, Form 38 (§ 43) was devised. It carries the records of a large number of houses in a very small book which easily fits the pocket. It should be written up daily, or at frequent intervals, from the rent ledger by the collector or the rent bookkeeper.

§ 332. Vacant Houses

It is of importance that the office should be immediately informed of any renting premises which are vacant, and each collector should make a report of these every day. It is a common practice to keep a list of vacant houses on a sheet or slate, and trust to no other record. If a large number of houses are cared for, some precaution must be taken to prevent the possibility of premises being overlooked. This depends largely on the rent bookkeeper, who should also act as a rental credit man. The board described in § 37, and originally designed from a hotel room board, has been found very serviceable for this purpose.

Building Accounts

§ 333. Building Operations and Building Accounts

Building operations fall into two main classes: first, where buildings for the improvement of property are erected without having any particular purchaser in view; second, where buildings are constructed for some definite purchaser. In both cases, however, an account should be opened in the ledger for each building erected, and to this account should be charged the numerous payments that are

called for, the account being kept open until some time after the building is completed, in order to satisfy the owner that no liens have been or can be filed against the building.

If the building is of the first class mentioned above, the total cost on completion is transferred to the Improvements account by a simple journal entry such as follows:

Improvements	$......	
To Buildings (No. and Street).........		$......
For the total cost of the above building on property No......		

When building for customers, the concern may perhaps simply agree to erect the desired building, the customer engaging to pay the price, the exact amount of which may not be finally determined until the building is completed. In such cases the Construction account is treated as is Improvement account in the entry just given.

On the other hand, a concern will frequently agree to build a house for a customer for a certain amount and will then make a contract with some builder, or erect the building itself, intending to obtain in either contingency a profit on the building. In such cases the construction account is credited and the purchaser debited with the price agreed upon. Upon completion of the building, there is usually a balance on one side of the ledger or the other; if it be a credit balance, there is of course a profit, and *vice versa*. This balance is then carried to the Profits account, the entry in the ledger indicating that it is the profit from building operations.

§ 334. Building Operations—Subdividing Costs

It is sometimes desired to analyze the cost of each building, especially for the purpose of comparing such costs with the estimates. This can very readily be done by preparing

some such schedule as follows, showing the various subdivisions into which it is desired to divide the work:

1. Masonry
2. Carpenter work
3. Roofing and metal work
4. Plastering
5. Plumbing
6. Painting
7. Electric wiring
8. Electric fixtures
9. Mantels
10. Hardwood floors
11. General lumber
12. Mill work
13. Hardware

When the bills for these various items are approved, it is indicated on the bill to which divisions the items are chargeable, and when paid the bookkeeper makes the cash book entries in a form similar to the following: "Building Green House, paid J. Graham (No. 5) $75," the number indicating that this charge pertains to plumbing.

When this item is posted to the ledger, the designating number is also inserted. Upon the completion of the building it is then a very simple matter to group together all those amounts indicated by the same number, and thus obtain very quickly a complete analysis of the cost of the building. This analysis may, if desired, be entered as a memorandum on the ledger page. It will frequently happen that one bill may be applicable to two or more divisions, such as plumbing and roofing, in which case the cash book entry must be divided to correspond.

CHAPTER XXXV

TAXES

§ 335. Entering Tax Payments on the Books

The method of paying taxes varies so greatly that no general rules can be given. In all cases, however, some form of tax receipt is obtained. Sometimes such a receipt bears full description of the lands; sometimes, if the list is a long one, the collector attaches the list itself to the receipt form. When the official receipt reaches the owner, it is immediately carefully checked against the tax list in order to see that no improper changes or omissions have been made, for any such errors can best be corrected immediately. From these original tax receipts, entries are made in the property ledgers showing the number of each receipt, the amount of the assessment, and the amount of the tax. It is found convenient and useful in practice to enter the assessed value, for in some cases (for instance, wild lands) these assessments are raised, and this fact may escape the owner's attention, until he looks at his tax record in the property ledger, when the increase at once becomes apparent.

Tax receipts should be carefully preserved in files of sufficient size to receive them without folding, and enable quick reference to be made to them. The receipts for each county are placed together, and the counties are arranged in alphabetical order. It may be that some of the property owned lies in small towns in various counties, and that these towns also assess city taxes. In such cases, this property should be placed at the end of the list for the county in

which it is situated; for if it should be placed among the regular lists, there is a possibility of the receipt being overlooked.

It is a good practice to make a note in red ink on each ledger sheet on which property subject to city taxes is entered, similar to the following: "Pay City Taxes"; and also to enter the dates upon which these taxes should be paid, as these do not coincide with the dates of payment for county taxes. The method followed for the payment of the ordinary city taxes is exactly similar to that used for the county taxes.

Probably the simplest way to enter tax payments on the books is to charge to Taxes account each check as it is given, and when the final tax receipt is received from the collector, to pick out from it all those properties upon which taxes have been paid which are covered by time sales and which are payable by the purchasers. A list of these is made, and a journal entry is put through the books in the following form:

Contracts	$......	
To Taxes..............................		$......
For the following taxes for the year ......:		
Contract No. .... Name		
Amount		

The total of this is charged to the Contracts account in the general ledger, and the various items to the individual accounts in the sub-ledger. After crediting the Tax account with the above entries, the net balance is carried each year direct to Profit and Loss, the reason for this being discussed in § 68. In the event of taxes having been paid in advance, it may be proper to carry all such amounts as an asset in the manner customary in connection with prepaid insurance.

§ 336. Mortgage Taxes

It is essential, of course, that a concern which has outstanding a number of mortgages receivable should keep itself acquainted with the facts as to the payment of the taxes payable by the mortgagor, especially as it is often the case that the mortgagor postpones such payments and they

DESCRIPTION OF LANDS IN ______________________ COUNTY
Paid on for 191 as per attached tax receipt number ________
ISSUED TO ______________________________

PARTS OF SECTION	SEC.	T.	R.	ACRES 100ths	RATE OF TAX	VALUATION	AMOUNT

Form 53. Tax Return

fall upon the concern. In order to care for these, separate tax lists are made for each county and headed "Mortgage Taxes," and these lists agree with the details given on Form 53, except that the name of the mortgagor is given against each description. As it is the custom in many states to assess the property under the name of the owner, this insertion facilitates reference on the part of the tax collector.

The safe practice is to make lists showing every piece of mortgaged property, and to send them to the tax collector a short time before the books are closed, asking him to note all unpaid taxes thereon and to return this list to the concern. When such taxes are paid they are, of course, charged direct to "Mortgage Taxes" and should not go through the regular tax accounts. It is to be noted, also, that occasionally taxes include certain assessments for improvements, such as draining wild lands. Each such case must be taken on its own merits, as it is possible that the amounts paid for these assessments, although paid with taxes, may properly be chargeable to Improvements.

§ 337. Descriptions

Before leaving the subject of taxes, one other difficulty should be mentioned, and that is the various descriptions of the property used by the assessors and collectors. In the case of an irregular piece of land the full description of which by metes and bounds occupies many lines, or even pages, it is manifestly impossible for the full description to appear on the tax books. The assessor therefore seeks a shorter description and defines the land by giving the book and page on which is recorded a deed conveying the land in question, as for instance, "Part of the Segui Grant, 100 acres in Section 37, T.3, S.R. 26 E., as recorded in Deed Book B.2 p. 204."

When this entry is first put on the books, it is probably correct, but as years go on and it is copied from roll to roll, errors creep in and the book, or the page, or some number, is changed. Or, the property may be reconveyed, and a new assessor may describe it properly under the book and page in which the new deed is recorded. Such variations constantly occur and render difficult the reconcilement of the returns made with the receipts obtained. To prevent

this, reference to the records themselves or to an abstract of title is frequently necessary, and even then it may be found that the land has been assessed under both descriptions. In such a case, proper steps should be taken to have one of the assessments cancelled.

A reference to Form 22 (§ 26) will show how these mistakes may be minimized in practice; for on the front of the page is given the full description, while on the back thereof is given the description or descriptions used by the assessors. This addition to the usual form has proved to be of great service and its adoption is recommended. In the same way, descriptions by county assessors frequently differ from those of municipal assessors, and these differences in the descriptions should always be clearly stated on the form.

If proper attention be given and correct returns made, such mistakes can be cured for future years, for almost invariably tax assessors are desirous of bringing their records to as high a degree of accuracy as their opportunities will permit.

§ 338. Federal Income Tax

In those cases where the fiscal year of the concern ends December 31, the annual return to be made in connection with the income tax is easily prepared from the balance sheet and its accompanying statements. In many instances the fiscal year does not end on that date, and many concerns have been put to considerable trouble to prepare an accurate statement for the calendar year. If the accounts have been kept as indicated herein, there is little difficulty in compiling figures, especially if monthly statements have been prepared as suggested in Chapter XXVII. In such cases it is only necessary to add the total expenses for the twelve months; the total profits and the other figures as

to indebtedness can be supplied from the current trial balance.

In cases where no monthly statements have been prepared, the earnings can best be ascertained in the manner indicated in § 259. In this the total profits for the year, such as rent, etc., are taken, and also the total collections from contracts, while the profits thereon are estimated at a percentage ascertained either from the balance sheets of previous years or from an examination of the contracts themselves. Such profits, of course, can always be ascertained if we know the cost of the properties sold and the amount of the selling price.

§ 339. Distinction between "Gains" and "Profits"

The published decisions of the Treasury Department up to this date require that all profits shown on the books in any year must be treated as income during that year. On the other hand, such profits as are lost through cancellations are allowed to be charged off as losses in future years. This includes, of course, gains derived from real estate sold on time; and the fact that the books of land companies usually show such gains as profits has necessitated, in many cases, the payment of taxes on profits not received, not earned. This ruling adds to the importance of a proper treatment of such gains, and it is believed that the methods described in Chapters XX, XXII, and XXIII will avoid these unnecessary tax payments for book profits. "Gains" should never be treated as profits, nor even be called "profits," and therefore could not come under the existing decisions as to profits. The term "profits" as used in this work apply only to such profits as are fully earned.

CHAPTER XXXVI

FILING

§ 340. Scope of Filing System

An important part of the work in a real estate office is that connected with filing the various papers and documents relating to the business so that each may be found without loss of time. A list of such papers would include: deeds conveying property to the concern; abstracts of title relating to the above, and attorney's certificates thereto; title policies; mortgages receivable; contracts given by the concern; contracts assumed by the concern; selling contracts; options given and received; fire insurance policies; tax receipts; sundry agreements, leases, releases, etc.

All such papers should be kept in a vault or safe with each class of documents numbered consecutively (abstracts being given the same number as the piece of property to which each relates) and filed in order; a record being kept in proper books, as already suggested.

§ 341. Consecutive Numbering

The advantages of using consecutive numbers in real estate accounting are so great and so many that their adoption is in many cases essential. Let us first consider the instances where such numbers must be employed:

1. All receipts must be numbered consecutively, not only for convenience of record, but also as a safeguard against fraud. If several collectors (e.g., for rents) are employed, it is often wise to have the receipt books numbered in different series, each series being distinguished by

a different letter and each letter being assigned to one particular collector.

2. All checks, whether voucher checks or otherwise, must be numbered, and if several banks are used, the checks on each bank should be numbered consecutively.

3. All mortgages receivable should be consecutively numbered, and this order usually affords the most convenient basis of arrangement for the mortgages receivable ledger. This instance affords one of the exceptions to the general rule that loose-leaf records should be arranged alphabetically.

4. Mortgages payable are treated in the same manner.

5. General contracts are usually arranged in order of the serial numbers and also chronologically.

6. Properties when bought should receive "property numbers" (§ 25), for this affords by far the most convenient means of reference in all book and record entries relating thereto.

In some offices where serial numbers are employed, a letter of the alphabet is selected to indicate each series of numbers. For example:

Mortgages	receivable	will	be	A-1,	A-2,	etc.
"	payable	"	"	B-1,	B-2,	"
"	contracts	"	"	C-1,	C-2,	"

The numbering of contracts on subdivision properties is of especial advantage; but in those cases where the number of purchasers in any one subdivision is large, it is usually found convenient to arrange all sub-ledgers on a strictly alphabetical basis, and to use indexes finely subdivided, say 120 divisions to the alphabet.

All deeds of conveyance should be numbered serially. Where subdivision property is dealt with, a special deed for each division should be used, the name of the property and

the grantor being printed, and in such instances each subdivision should have its own series of numbers.

Abstracts of title should bear the numbers of the real estate to which they refer, and should be filed in this order.

For renting purposes, where the list of houses remains substantially the same, it is frequently convenient to give each house, apartment, or flat a serial number. In the case of small tenement property, this method is particularly valuable; and in cases where street numbers are lacking or confused, if the serial number can be stencilled or painted on some portion of the house, it gives the collector a double check on the description, which is frequently useful.

§ 342. Sundry Documents

These papers are perhaps the most difficult of all to file in such a way that any particular one may be found quickly when necessary. After trying several methods, the writer has adopted the following plan, which fully serves the desired ends:

Each paper to be filed is stamped with a serial number and put in a manila envelope, which is stamped with the same number. The envelopes are then filed in numerical order, irrespective of the nature of the document.

A double card index is used, divided into two parts, each of which is indexed alphabetically. One of these parts is used for indexing the names of the parties mentioned in the various documents, and the other part is used for indexing the nature of the various papers filed, such as "Agreements," "Bills of Sale," "Escrow Agreements," "Timber Leases," "Affidavits," etc.

Each paper as it is filed is entered in both parts of this index; e.g., a bill of sale from James Young would be entered on a card headed "Bills of Sale" and filed under "B" in one part of the index, and would also be entered on an-

other card under "Young, James" and filed under "Y" in the other part of the index. Against the entry on each card is shown the number stamped on the envelope in which the paper is filed.

This system takes but little time, and by it a paper can be quickly found if either the nature of the paper or the name of any party making it is known.

§ 343. Ticklers

In such a business as we have been considering, there are payments of interest to be made each month, as well as collections from mortgagors who are in arrears. In order to insure all such collections receiving attention, a tickler must be used, such, for example, as a bank cashier keeps. There are so many forms of these, each of which fills its purpose, that no description of any one seems necessary.

INDEX TO FORMS

(Figures in parentheses indicate form numbers.)

GENERAL INDEX

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